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# COMMITTEE ON WAYS AND MEANS
# U.S. HOUSE OF REPRESENTATIVES

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# BACKGROUND MATERIALS ON FEDERAL BUDGET AND TAX POLICY FOR FISCAL YEAR 1992 AND BEYOND

Prepared for Hearings To Be Held Beginning on
March 5, 1991

**FEBRUARY 28, 1991**

Prepared for the use of Members of the Committee on Ways and Means by members of its staff. This document has not been officially approved by the Committee and may not reflect the views of its Members

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## COMMITTEE ON WAYS AND MEANS
## U.S. HOUSE OF REPRESENTATIVES

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### ONE HUNDRED SECOND CONGRESS
### DAN ROSTENKOWSKI, ILLINOIS, *Chairman*

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# PART 1—BUDGET AND TAX TABLES

## DESCRIPTION OF TABLES

### Overview

The following tables and charts are compiled from a variety of Congressional Budget Office (CBO), Office of Management and Budget (OMB) publications, and Health and Human Resources documents. The first nine tables present CBO baseline estimates for the next five fiscal years and some historical data. Table 10 illustrates a summary of proposed policy changes in entitlement programs under the jurisdiction of the Committee on Ways and Means. Table 11 presents the same information in detail for each provision. Tables 10 and 11 are based upon Administration estimates of these policy changes. Table 12 presents Joint Committee on Taxation (JCT) and CBO estimates of revenue provisions in the Administration's fiscal year 1992 budget. Table 13 compares economic assumptions used in the preceding budget projections and table 14 shows the effects of different economic assumptions on revenues, outlays and the deficit. Tables 15 though 19 and Charts 1 and 2 present data on selected social indicators and show family income trends over time.

Table 15 illustrates several different approaches to measuring trends in family income and income inequality. These approaches all track trends in family income by looking at income over time, adjusted for inflation, by income quintiles. Income quintiles are fifths of the income distribution, defined by ordering all relevant family units from that with the lowest income to that with the highest. The bottom quintile is the lowest (poorest) fifth of that order, while the top quintile is the highest (richest) fifth. Quintiles may be defined separately for each family type, in which case the quintile a particular family is in, says nothing about its place in the overall income distribution for all families as a group, but does reflect changes in income inequality within that particular family type.

The three years, 1973, 1979 and 1989, are used in this study because they represent peak years in the economic cycle. Using only three years also simplifies the analysis significantly. In viewing incomes from different years, the dollar amounts must be adjusted for inflation in order to compare actual buying power. Adjustment for inflation is made using the CPI–X1 price index.

The top panel of Table 15 shows changes in mean-family cash incomes in constant 1989 dollars, from 1973 to 1989. This is the common method of analysis of changes in income distribution. However, unlike the Census Bureau analysis, these numbers include families and single individuals. This methodology assumes a

family of six can live as cheaply as a family of one. The quintiles are based upon 20 percent of all families in each quintile.

The third panel of Table 15 shows exactly the same data as the first panel and is adjusted for inflation in an identical fashion. However, family income is divided by the number of persons in the family and the population is ranked from low to high with each quintile representing exactly 20 percent of the population, not 20 percent of the families. This assumes that a family of six requires six times as much income as a family of one to be equivalent. The picture of income changes over time is quite different from that in the top panel.

The second panel, assuming the same data as those used in panels 1 and 3, uses the poverty thresholds as a family size adjustor. It assumes that a family of four takes twice as much income as a family of one. Unlike the analysis of the 1990 edition of the Green Book, the poverty thresholds are not adjusted for the age of the head of household.

The last panel in Table 15 illustrates the change in family income by adding near-cash transfer payments such as food stamps, housing benefits, and school nutrition programs. It also subtracts from income, individual income tax and payroll tax payments. The pattern of income change is similar to that in panel 2.

Table 16 is identical to panel two in Table 15 and shows changes in income for different family types by income quintile.

Another way of tracking income trends over time is to look at the changes in income distribution by calculating the percentage share of income for each quintile. These are shown in Table 17.

Table 18 and Chart 1 uses the same methodology as pages 962–992 of the 1990 Green Book and shows what happens to disposable income for various real wage levels across time for one parent with two children.

Table 19 presents selected statistics on families and children over time including data on the percent change in real family income, the percent of children in poverty, the living arrangements of children, rates of infant mortality, and the number of children in foster care.

## TABLE 1. CBO PROJECTIONS OF TOTAL FEDERAL REVENUES, OUTLAYS, AND DEFICITS (By fiscal year)

| | Actual 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 |
|---|---|---|---|---|---|---|---|
| | | | **In Billions of Dollars** | | | | |
| Baseline | | | | | | | |
| Revenues | 1,031 | 1,094 | 1,170 | 1,251 | 1,332 | 1,416 | 1,496 |
| Outlays | 1,252 | 1,391 | 1,468 | 1,490 | 1,543 | 1,544 | 1,632 |
| Deficit | 220 | 298 | 298 | 239 | 211 | 128 | 135 |
| Required Reductions[a] | | | | | | | |
| Discretionary spending | n.a. | n.a. | 13 | 22 | 46 | 62 | 65 |
| Debt service savings | n.a. | n.a. | 1 | 2 | 5 | 9 | 14 |
| Subtotal | n.a. | n.a. | 14 | 24 | 51 | 71 | 79 |
| Totals Assuming Discretionary Caps | | | | | | | |
| Revenues | 1,031 | 1,094 | 1,170 | 1,251 | 1,332 | 1,416 | 1,496 |
| Outlays | 1,252 | 1,391 | 1,454 | 1,466 | 1,492 | 1,473 | 1,553 |
| Deficit | 220 | 298 | 284 | 215 | 160 | 57 | 56 |
| | | | **As a Percentage of GNP** | | | | |
| Baseline Deficit | 4.1 | 5.3 | 5.0 | 3.7 | 3.1 | 1.8 | 1.8 |
| Totals Assuming Discretionary Caps | | | | | | | |
| Revenues | 19.1 | 19.4 | 19.5 | 19.5 | 19.5 | 19.5 | 19.4 |
| Outlays | 23.2 | 24.7 | 24.2 | 22.9 | 21.9 | 20.3 | 20.2 |
| Deficit | 4.1 | 5.3 | 4.7 | 3.4 | 2.4 | 0.8 | 0.7 |
| **Memorandum:** | | | | | | | |
| Gross National Product (In billions of dollars) | 5,406 | 5,624 | 6,003 | 6,405 | 6,813 | 7,246 | 7,705 |

SOURCE: Congressional Budget Office.

NOTES: The projections include Social Security and the Postal Service, which are off-budget.

n.a. = not applicable.

a. The discretionary spending caps apply only through 1995. The 1996 figure is an extrapolation.

## TABLE 2. CBO DEFICIT PROJECTIONS
(By fiscal year)

| | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 |
|---|---|---|---|---|---|---|---|
| | | | | In Billions of Dollars | | | |
| Baseline Total Deficit | 220 | 298 | 298 | 239 | 211 | 128 | 135 |
| Assuming Discretionary Spending Limits[a] | | | | | | | |
| Total deficit | 220 | 298 | 284 | 215 | 160 | 57 | 56 |
| Deficit excluding deposit insurance | 162 | 194 | 186 | 167 | 135 | 103 | 99 |
| On-budget deficit[b] | 277 | 360 | 354 | 294 | 258 | 170 | 185 |
| | | | | As a Percentage of GNP | | | |
| Baseline Total Deficit | 4.1 | 5.3 | 5.0 | 3.7 | 3.1 | 1.8 | 1.8 |
| Assuming Discretionary Spending Limits[a] | | | | | | | |
| Total deficit | 4.1 | 5.3 | 4.7 | 3.4 | 2.4 | 0.8 | 0.7 |
| Deficit excluding deposit insurance | 3.0 | 3.5 | 3.1 | 2.6 | 2.0 | 1.4 | 1.3 |
| On-budget deficit[b] | 5.1 | 6.4 | 5.9 | 4.6 | 3.8 | 2.3 | 2.4 |

SOURCE: Congressional Budget Office.

a. The discretionary spending limits apply only through 1995. The 1996 figures are extrapolations.

b. Social Security and the Postal Service are outside the budget.

TABLE 3. CBO PROJECTIONS OF TRUST FUND SURPLUSES
(By fiscal year, in billions of dollars)

| Trust Fund | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 |
|---|---|---|---|---|---|---|
| Social Security | 63 | 70 | 82 | 96 | 112 | 129 |
| Medicare | 16 | 16 | 18 | 17 | 15 | 11 |
| Military Retirement[a] | 14 | 12 | 13 | 13 | 14 | 14 |
| Civilian Retirement[b] | 23 | 25 | 27 | 29 | 31 | 30 |
| Unemployment | -2 | 3 | 6 | 7 | 8 | 9 |
| Highway and Airport | 4 | 4 | 4 | 4 | 4 | 5 |
| Other | 3 | 1 | 1 | 2 | 2 | 2 |
| Total Trust Fund Surplus[c] | 120 | 131 | 151 | 169 | 186 | 201 |
| Federal Funds Deficit[c] | -418 | -415 | -365 | -329 | -243 | -257 |
| Total Deficit | -298 | -284 | -215 | -160 | -57 | -56 |
| **Memoranda:** | | | | | | |
| Trust Fund Deficit Excluding Transfers from General Fund | -59 | -59 | -58 | -60 | -65 | -75 |
| Federal Funds Deficit Excluding Transfers to Trust Funds | -239 | -225 | -157 | -100 | 8 | 19 |

SOURCE: Congressional Budget Office.

a. Civil Service Retirement, Foreign Service Retirement, and several smaller funds.

b. Primarily Railroad Retirement, employees' health insurance and life insurance, Hazardous Substance Superfund, and various veterans' insurance trust funds.

c. Assumes that discretionary spending reductions are made in non-trust-fund programs.

Table 4. – OUTLAYS FOR MAJOR SPENDING CATEGORIES FOR SELECTED YEARS IN NOMINAL DOLLARS, AND AS A PERCENT OF GNP
(by fiscal year)

| | 1965 | 1970 | 1975 | 1980 | 1985 | 1990 | 1995 |
|---|---|---|---|---|---|---|---|
| | | | | In nominal dollars (billions) | | | |
| National Defense | 50.6 | 81.7 | 86.5 | 134.0 | 252.7 | 299.3 | 289 |
| Social Security | 17.1 | 29.4 | 63.1 | 117.1 | 186.5 | 246.5 | 335 |
| Medicare | 0.0 | 6.8 | 14.1 | 33.9 | 69.8 | 107.4 | 173 |
| Medicaid | 0.3 | 2.7 | 6.8 | 14.0 | 22.7 | 41.1 | 80 |
| AFDC, SSI, Food Stamps | 2.8 | 4.7 | 14.1 | 22.2 | 30.4 | 41.0 | 60 |
| Deposit Insurance | –0.4 | –0.5 | 0.5 | –0.4 | –2.2 | 58.1 | –47 |
| Other Entitlements | 14.5 | 22.6 | 58.2 | 90.0 | 128.0 | 184.4 | 223 |
| Non–defense Discretionary | 32.3 | 45.0 | 84.7 | 157.6 | 174.9 | 205.6 | 252 |
| Net Interest | 8.6 | 14.4 | 23.2 | 52.5 | 129.4 | 183.8 | 230 |
| Offsetting Receipts | –8.0 | –11.6 | –18.5 | –30.3 | –48.0 | –57.2 | –76 |
| Total | 117.8 | 195.2 | 332.7 | 590.6 | 944.2 | 1251.9 | 1473 |
| Memo: GNP | 672.6 | 990.2 | 1522.5 | 2670.6 | 3952.4 | 5405.7 | 7246 |
| | | | | As a percent of GNP | | | |
| National Defense | 7.5 | 8.3 | 5.7 | 5.0 | 6.4 | 5.5 | 4.0 |
| Social Security | 2.5 | 3.0 | 4.1 | 4.4 | 4.7 | 4.6 | 4.6 |
| Medicare | 0.0 | 0.7 | 0.9 | 1.3 | 1.8 | 2.0 | 2.4 |
| Medicaid | 0.0 | 0.3 | 0.4 | 0.5 | 0.6 | 0.8 | 1.1 |
| AFDC, SSI, Food Stamps | 0.4 | 0.5 | 0.9 | 0.8 | 0.8 | 0.8 | 0.8 |
| Deposit Insurance | –0.1 | –0.1 | 0.0 | 0.0 | –0.1 | 1.1 | –0.6 |
| Other Entitlements | 2.2 | 2.3 | 3.8 | 3.4 | 3.2 | 3.4 | 3.1 |
| Non–defense Discretionary | 4.8 | 4.5 | 5.6 | 5.9 | 4.4 | 3.8 | 3.5 |
| Net Interest | 1.3 | 1.5 | 1.5 | 2.0 | 3.3 | 3.4 | 3.2 |
| Offsetting Receipts | –1.2 | –1.2 | –1.2 | –1.1 | –1.2 | –1.1 | –1.0 |
| Total | 17.5 | 19.7 | 21.9 | 22.1 | 23.9 | 23.2 | 20.3 |
| Memo: Social Security, Medicare and Medicaid | 2.6 | 3.9 | 5.5 | 6.2 | 7.1 | 7.3 | 8.1 |
| | | | | As a percent of budget | | | |
| National Defense | 43.0 | 41.9 | 26.0 | 22.7 | 26.8 | 23.9 | 19.6 |
| Social Security | 14.5 | 15.1 | 19.0 | 19.8 | 19.8 | 19.7 | 22.7 |
| Medicare | 0.0 | 3.5 | 4.2 | 5.7 | 7.4 | 8.6 | 11.7 |
| Medicaid | 0.3 | 1.4 | 2.0 | 2.4 | 2.4 | 3.3 | 5.4 |
| AFDC, SSI, Food Stamps | 2.4 | 2.4 | 4.2 | 3.8 | 3.2 | 3.3 | 4.1 |
| Deposit Insurance | –0.3 | –0.3 | 0.2 | –0.1 | –0.2 | 4.6 | –3.2 |
| Other Entitlements | 12.3 | 11.6 | 17.5 | 15.2 | 13.6 | 14.7 | 15.1 |
| Non–defense Discretionary | 27.4 | 23.1 | 25.5 | 26.7 | 18.5 | 16.4 | 17.1 |
| Net Interest | 7.3 | 7.4 | 7.0 | 8.9 | 13.7 | 14.7 | 15.6 |
| Offsetting Receipts | –6.8 | –5.9 | –5.6 | –5.1 | –5.1 | –4.6 | –5.2 |
| Total | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |

Source: Congressional Budget Office

## TABLE 5. OUTLAYS BY CATEGORY, ASSUMING COMPLIANCE WITH DISCRETIONARY SPENDING CAPS (By fiscal year)

| Spending Category | Actual 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 |
|---|---|---|---|---|---|---|---|
| | | | In Billions of Dollars | | | | |
| National Defense[a] | 299 | 299 | 295 | 292 | b | b | b |
| International Discretionary | 19 | 19 | 19 | 20 | b | b | b |
| Domestic Discretionary[c] | 186 | 203 | 211 | 223 | b | b | b |
| Subtotal | 505 | 521 | 526 | 536 | 536 | 541 | 560 |
| Entitlements and Other Mandatory Spending, Excluding Deposit Insurance | 562 | 632 | 687 | 731 | 776 | 824 | 881 |
| Deposit Insurance | 58 | 103 | 98 | 48 | 25 | -47 | -42 |
| Offsetting Receipts | -57 | -63 | -63 | -67 | -71 | -76 | -79 |
| Net Interest | 184 | 198 | 207 | 219 | 227 | 230 | 233 |
| Total | 1,252 | 1,391 | 1,454 | 1,466 | 1,492 | 1,473 | 1,553 |
| On-budget | 1,027 | 1,154 | 1,205 | 1,204 | 1,224 | 1,196 | 1,266 |
| Off-budget[d] | 225 | 237 | 249 | 262 | 268 | 277 | 287 |
| | | | As a Percentage of GNP | | | | |
| National Defense[a] | 5.5 | 5.3 | 4.9 | 4.6 | b | b | b |
| International Discretionary | 0.4 | 0.3 | 0.3 | 0.3 | b | b | b |
| Domestic Discretionary[c] | 3.4 | 3.6 | 3.5 | 3.5 | b | b | b |
| Subtotal | 9.3 | 9.3 | 8.8 | 8.4 | 7.9 | 7.5 | 7.3 |
| Entitlements and Other Mandatory Spending, Excluding Deposit Insurance | 10.4 | 11.2 | 11.4 | 11.4 | 11.4 | 11.4 | 11.4 |
| Deposit Insurance | 1.1 | 1.8 | 1.6 | 0.7 | 0.4 | -0.6 | -0.6 |
| Offsetting Receipts | -1.1 | -1.1 | -1.1 | -1.0 | -1.0 | -1.0 | -1.0 |
| Net Interest | 3.4 | 3.5 | 3.4 | 3.4 | 3.3 | 3.2 | 3.0 |
| Total | 23.2 | 24.7 | 24.2 | 22.9 | 21.9 | 20.3 | 20.2 |
| On-budget | 19.0 | 20.5 | 20.1 | 18.8 | 18.0 | 16.5 | 16.4 |
| Off-budget[d] | 4.2 | 4.2 | 4.1 | 4.1 | 3.9 | 3.8 | 3.7 |

SOURCE: Congressional Budget Office.

a. Almost all national defense outlays are discretionary. For simplicity, these figures include small amounts of defense offsetting receipts and mandatory spending (totaling about -$500 million to -$700 million annually) that lie outside the jurisdiction of the Appropriations Committees and are not subject to the cap.

b. Discretionary spending caps are specified by category through 1993 and in the aggregate for later years. Projections for 1996 represent a CBO extrapolation.

c. Includes $2 billion to $3 billion in administrative costs of Social Security, which (in CBO's view) are not subject to the discretionary spending cap. The Office of Management and Budget disputes this view.

d. Social Security and Postal Service.

## TABLE 6. CBO BASELINE PROJECTIONS FOR ENTITLEMENTS AND OTHER MANDATORY SPENDING, EXCLUDING DEPOSIT INSURANCE (By fiscal year, in billions of dollars)

| Category | Actual 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 |
|---|---|---|---|---|---|---|---|
| **Means-Tested Programs** | | | | | | | |
| Medicaid | 41 | 49 | 57 | 64 | 72 | 80 | 90 |
| Food Stamps[a] | 16 | 19 | 21 | 21 | 22 | 23 | 23 |
| Supplemental Security Income | 11 | 15 | 16 | 17 | 19 | 19 | 19 |
| Family Support | 13 | 15 | 16 | 16 | 17 | 18 | 18 |
| Veterans' Pensions | 4 | 4 | 4 | 4 | 4 | 4 | 3 |
| Child Nutrition | 5 | 5 | 6 | 6 | 7 | 7 | 7 |
| Earned Income Tax Credit | 4 | 5 | 6 | 7 | 8 | 10 | 11 |
| Stafford Loans[b,c] | 4 | 5 | 6 | 6 | 5 | 4 | 4 |
| Other | 2 | 3 | 3 | 3 | 3 | 4 | 5 |
| Total, Means-Tested Programs | 100 | 118 | 134 | 144 | 157 | 169 | 180 |
| **Non-Means-Tested Programs** | | | | | | | |
| Social Security | 246 | 266 | 284 | 301 | 318 | 335 | 353 |
| Medicare | 107 | 114 | 127 | 140 | 156 | 173 | 194 |
| Subtotal | 354 | 379 | 411 | 440 | 473 | 508 | 547 |
| Other Retirement and Disability | | | | | | | |
| Federal civilian[d] | 34 | 36 | 39 | 41 | 44 | 46 | 52 |
| Military | 22 | 23 | 25 | 26 | 27 | 29 | 30 |
| Other | 5 | 5 | 5 | 5 | 5 | 5 | 5 |
| Subtotal | 60 | 64 | 68 | 72 | 76 | 80 | 87 |
| Unemployment Compensation | 17 | 23 | 20 | 20 | 21 | 21 | 21 |
| Other Programs | | | | | | | |
| Veterans' benefits[c,e] | 13 | 15 | 16 | 17 | 18 | 18 | 17 |
| Farm price supports[c] | 6 | 11 | 12 | 10 | 9 | 9 | 8 |
| Social services | 5 | 6 | 6 | 6 | 5 | 5 | |
| Credit reform liquidating accounts[c] | 0 | 0 | 6 | 5 | 4 | 3 | 1 |
| Other | 6 | 16 | 14 | 16 | 12 | 12 | 14 |
| Subtotal | 31 | 47 | 54 | 54 | 49 | 46 | 46 |
| Total, Non-Means-Tested Programs | 462 | 513 | 553 | 587 | 619 | 656 | 701 |
| **Total** | | | | | | | |
| All Entitlements and Other Mandatory Spending, Excluding Deposit Insurance | 562 | 632 | 687 | 731 | 776 | 824 | 881 |

SOURCE: Congressional Budget Office.

NOTE: Spending for major benefit programs shown in this table includes benefits only. Outlays for administrative costs of most benefit programs are classified as nondefense discretionary spending, and Medicare premium collections as offsetting receipts.

a. Includes nutrition assistance to Puerto Rico.
b. Formerly known as guaranteed student loans.
c. Program affected by credit reform.
d. Includes Civil Service, Foreign Service, Coast Guard, and other retirement programs, and annuitants' health benefits.
e. Includes veterans' compensation, readjustment benefits, life insurance, and housing programs.

**TABLE 7. EFFECTS OF RECENT POLICY CHANGES ON CBO DEFICIT PROJECTIONS (By fiscal year, in billions of dollars)**

| | 1991 | 1992 | 1993 | 1994 | 1995 | Cumulative Five-Year Changes |
|---|---|---|---|---|---|---|
| Revenue Increases | -18 | -33 | -32 | -37 | -39 | -158 |
| Entitlements and Other Mandatory Spending | -9 | -12 | -16 | -19 | -19 | -75 |
| Enacted Appropriations | | | | | | |
| Defense | -6 | -14 | -20 | -24 | -26 | -91 |
| Nondefense | 1 | 8 | 11 | 12 | 13 | 45 |
| Subtotal | -6 | -6 | -9 | -12 | -13 | -46 |
| Required Reductions in Discretionary Spending | n.a. | -13 | -22 | -46 | -62 | -144 |
| Debt Service Savings | -1 | -4 | -10 | -17 | -27 | -59 |
| Total | -33 | -69 | -89 | -131 | -160 | -482 |

SOURCE: Congressional Budget Office.

NOTE: n.a. = not applicable.

TABLE 8. CBO BASELINE REVENUE PROJECTIONS BY SOURCE
(By fiscal year)

| Major Source | Actual 1990 | Base 1991 | Projected 1992 | 1993 | 1994 | 1995 | 1996 |
|---|---|---|---|---|---|---|---|
| | | | In Billions of Dollars | | | | |
| Individual Income | 467 | 489 | 529 | 569 | 612 | 660 | 705 |
| Corporate Income | 94 | 99 | 103 | 107 | 109 | 109 | 111 |
| Social Insurance | 380 | 404 | 433 | 464 | 496 | 528 | 560 |
| Excise | 35 | 46 | 49 | 53 | 54 | 56 | 54 |
| Estate and Gift | 12 | 12 | 13 | 13 | 14 | 14 | 15 |
| Customs Duties | 17 | 17 | 18 | 20 | 21 | 22 | 24 |
| Miscellaneous Receipts | 27 | 26 | 25 | 26 | 26 | 27 | 27 |
| Total | 1,031 | 1,094 | 1,170 | 1,251 | 1,332 | 1,416 | 1,496 |
| On-budget | 750 | 794 | 851 | 910 | 967 | 1,026 | 1,081 |
| Off-budget | 282 | 300 | 319 | 341 | 365 | 390 | 416 |
| | | | As a Percentage of GNP | | | | |
| Individual Income | 8.6 | 8.7 | 8.8 | 8.9 | 9.0 | 9.1 | 9.1 |
| Corporate Income | 1.7 | 1.8 | 1.7 | 1.7 | 1.6 | 1.5 | 1.4 |
| Social Insurance | 7.0 | 7.2 | 7.2 | 7.2 | 7.3 | 7.3 | 7.3 |
| Excise | 0.7 | 0.8 | 0.8 | 0.8 | 0.8 | 0.8 | 0.7 |
| Estate and Gift | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 |
| Customs Duties | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 |
| Miscellaneous Receipts | 0.5 | 0.5 | 0.4 | 0.4 | 0.4 | 0.4 | 0.4 |
| Total | 19.1 | 19.4 | 19.5 | 19.5 | 19.5 | 19.5 | 19.4 |
| On-budget | 13.9 | 14.1 | 14.2 | 14.2 | 14.2 | 14.2 | 14.0 |
| Off-budget | 5.2 | 5.3 | 5.3 | 5.3 | 5.4 | 5.4 | 5.4 |

SOURCE: Congressional Budget Office.

## TABLE 9. CBO PROJECTIONS OF INTEREST COSTS AND FEDERAL DEBT (By fiscal year)

| | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 |
|---|---|---|---|---|---|---|---|
| **Net Interest Outlays (In billions of dollars)** | | | | | | | |
| Interest on Public Debt (Gross interest)[a] | 265 | 292 | 312 | 337 | 355 | 367 | 377 |
| Interest Received by Trust Funds | | | | | | | |
| Social Security | -16 | -21 | -26 | -31 | -37 | -45 | -53 |
| Other trust funds[b] | -46 | -52 | -54 | -57 | -61 | -65 | -68 |
| Subtotal | -62 | -73 | -79 | -88 | -98 | -109 | -121 |
| Other Interest[c] | -19 | -21 | -26 | -30 | -30 | -28 | -23 |
| Total | 184 | 198 | 207 | 219 | 227 | 230 | 233 |
| **Federal Debt, End of Year (In billions of dollars)** | | | | | | | |
| Gross Federal Debt | 3,206 | 3,606 | 4,018 | 4,383 | 4,716 | 4,964 | 5,227 |
| Debt Held by Government Accounts | | | | | | | |
| Social Security | 215 | 278 | 348 | 430 | 526 | 638 | 767 |
| Other government accounts[b] | 581 | 635 | 697 | 769 | 844 | 921 | 995 |
| Subtotal | 796 | 913 | 1,045 | 1,198 | 1,370 | 1,558 | 1,762 |
| Debt Held by the Public | 2,410 | 2,693 | 2,973 | 3,185 | 3,346 | 3,405 | 3,465 |
| Debt Subject to Limit[d] | 3,161 | 3,565 | 3,980 | 4,348 | 4,682 | 4,931 | 5,195 |
| **Federal Debt as a Percentage of GNP** | | | | | | | |
| Debt Held by the Public | 44.6 | 47.9 | 49.5 | 49.7 | 49.1 | 47.0 | 45.0 |

SOURCE: Congressional Budget Office.

NOTE: Projections of interest and debt assume compliance with the discretionary spending caps in the Budget Enforcement Act.

a. Excludes interest costs of debt issued by agencies other than the Treasury (primarily deposit insurance agencies).

b. Principally Civil Service Retirement, Military Retirement, Medicare, Unemployment Insurance, and the Highway and the Airport and Airway trust funds.

c. Primarily interest on loans to the public and to the Resolution Trust Corporation.

d. Differs from the gross federal debt primarily because most debt issued by agencies other than the Treasury (currently about $33 billion) is excluded from the debt limit.

Table 10.-- Proposed Administration Policy Changes in Entitlement Programs Under the Jurisdiction of the Committee on Ways and Means (in millions of dollars)
Administration estimates

| | 1992 | 1993 | 1994 | 1995 | 1996 | 1992-96 |
|---|---|---|---|---|---|---|
| Medicare | | | | | | |
| Clinical Labs | -470 | -850 | -970 | -1100 | -1250 | -4640 |
| DME | -45 | -100 | -120 | -145 | -150 | -560 |
| High income beneficiary premium increase | -41 | -169 | -245 | -323 | -426 | -1204 |
| Hospitals and Outpatients | -1945 | -2625 | -3400 | -3970 | -4545 | -16485 |
| Physicians | -170 | -340 | -430 | -510 | -585 | -2035 |
| Other | -303 | -67 | 29 | 126 | 342 | 127 |
| Subtotal - Medicare | -2974 | -4151 | -5136 | -5922 | -6614 | -24797 |
| Social Security and Railroad Retirement | 201 | 161 | 83 | 71 | 67 | 583 |
| Child support enforcement | -120 | -137 | -154 | -175 | -191 | -777 |
| SSI | -96 | -159 | -250 | -250 | -240 | -995 |
| Foster care | -209 | -290 | -352 | -405 | -452 | -1708 |
| Trade Adjustment Assistance | -114 | -193 | -204 | -200 | -194 | -905 |
| TOTAL | -3312 | -4769 | -6013 | -6881 | -7624 | -28599 |
| Total - All Entitlement Programs | -6316 | -9344 | -8984 | -10987 | -10999 | -46630 |

Source: HHS and OMB

TABLE 11.--ADMINISTRATION LEGISLATIVE PROPOSALS FOR PROGRAMS WITHIN THE JURISDICTION OF THE COMMITTEE ON WAYS AND MEANS

(Administration preliminary estimates, by fiscal years, in millions)

| | 1992 | 1993 | 1994 | 1995 | 1996 | Total 1992-96 |
|---|---|---|---|---|---|---|
| MEDICARE: | | | | | | |
| PPS update | -680 | -940 | -1330 | -1460 | -1550 | -5960 |
| Indirect Medical Education | -1045 | -1385 | -1705 | -2080 | -2500 | -8715 |
| Direct Medical Education | -140 | -160 | -190 | -230 | -260 | -980 |
| DRG Payment Window | -30 | -40 | -50 | -50 | -60 | -230 |
| Eliminate Return on Equity (ROE) Payments to Skilled Nursing Facilities (SNFs) | -50 | -70 | -60 | -60 | -70 | -310 |
| Update for physician fees | -30 | --- | --- | --- | --- | -30 |
| Medicare volume performance standard for 1991 | --- | -90 | -150 | -190 | -220 | -650 |
| Anesthesiology services | -80 | -150 | -170 | -200 | -230 | -830 |
| Payments for assistants-at-surgery | -50 | -80 | -90 | -100 | -110 | -430 |
| Eliminate payments for specimen collections | -10 | -20 | -20 | -20 | -25 | -95 |
| Payments for covered drugs | -10 | -30 | -30 | -40 | -40 | -150 |
| Payments for radiology and other diagnostic tests | --- | -10 | -15 | -20 | -20 | -65 |
| Clinical laboratory services - copay | -450 | -800 | -900 | -1020 | -1160 | -4330 |
| Reduce update | -20 | -50 | -70 | -80 | -90 | -310 |
| Durable medical equipment | -35 | -85 | -105 | -130 | -135 | -490 |
| Enteral/parenteral fee schedule | -10 | -15 | -15 | -15 | -15 | -70 |
| Hospital outpatient department services | -50 | -100 | -125 | -150 | -175 | -600 |
| Payments to providers for physical and respiratory therapy services | -10 | -10 | -15 | -15 | -20 | -70 |
| Home health cost limits | -90 | -115 | -125 | -135 | -145 | -610 |
| Uniform medicare secondary payer employee size threshold | | | | | | |
| Part A | -55 | -65 | -75 | -90 | -105 | -390 |
| Part B | -25 | -25 | -35 | -40 | -45 | -170 |
| Total | -80 | -90 | -110 | -130 | -150 | -560 |
| Part B premium | -41 | -169 | -245 | -323 | -426 | -1204 |
| State certification user fee | | | | | | |
| Part A | -131 | -140 | -141 | -141 | -141 | -694 |
| Part B | -30 | -21 | -21 | -21 | -21 | -114 |
| Total | -161 | -161 | -162 | -162 | -162 | -808 |
| Coordinated care initiatives | | | | | | |
| Part A | 25 | 75 | 90 | 105 | 120 | 415 |
| Part B | 15 | 155 | 185 | 230 | 370 | 955 |
| Total | 40 | 230 | 275 | 335 | 490 | 1370 |
| Effect of Medicare proposals on HI premiums | 17 | 20 | 26 | 30 | 33 | 126 |
| Subtotal | -2974 | -4151 | -5136 | -5922 | -6614 | -24797 |

TABLE 11.—ADMINISTRATION LEGISLATIVE PROPOSALS FOR PROGRAMS WITHIN THE JURISDICTION OF THE COMMITTEE ON WAYS AND MEANS — Continued

(Administration preliminary estimates, by fiscal years, in millions)

| | 1992 | 1993 | 1994 | 1995 | 1996 | Total 1992–96 |
|---|---|---|---|---|---|---|
| SOCIAL SECURITY AND RAILROAD RETIREMENT: | | | | | | |
| Social Security retirement test | 130 | 95 | 15 | 0 | 0 | 240 |
| Social Security benefits for Railroad Retirement dependents | 71 | 66 | 68 | 71 | 67 | 343 |
| Subtotal | 201 | 161 | 83 | 71 | 67 | 583 |
| CHILD SUPPORT ENFORCEMENT | | | | | | |
| Incentive payments | –54 | –66 | –77 | –92 | –103 | –392 |
| Application fees | –66 | –71 | –77 | –83 | –88 | –385 |
| Subtotal | –120 | –137 | –154 | –175 | –191 | –777 |
| SUPPLEMENTAL SECURITY INCOME | | | | | | |
| Fee for administration of state supplementation | –60 | –135 | –230 | –230 | –220 | –875 |
| Collection of SSI overpayments | –36 | –24 | –20 | –20 | –20 | –120 |
| Subtotal | –96 | –159 | –250 | –250 | –240 | –995 |
| CHILD WELFARE SERVICES AND FOSTER CARE | | | | | | |
| Prohibition on reimbursement for pre-placement activities | –209 | –290 | –352 | –405 | –452 | –1708 |
| TRADE ADJUSTMENT ASSISTANCE | | | | | | |
| Terminate the TAA program | –114 | –193 | –204 | –200 | –194 | –905 |
| TOTAL | –3312 | –4769 | –6013 | –6881 | –7624 | –28599 |

Source: HHS and OMB

## TABLE 12.—Estimated Budget Effects of Revenue Provisions in the President's Fiscal Year 1992 Budget Proposal

Fiscal Years 1991–1996

[Billions of Dollars]

| Provisions | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1991–96 |
|---|---|---|---|---|---|---|---|
| ***A. Income Tax Provisions*** | | | | | | | |
| 1. Capital gains tax rate reduction for individuals | 0.8 | 3.7 | −3.2 | −4.4 | −4.1 | −3.4 | −10.6 |
| 2. Establish family savings accounts | ..... | −0.4 | −0.6 | −1.0 | −1.4 | −1.8 | −5.2 |
| 3. Waive penalty tax for early withdrawals from IRAs for first-time home buyers | ..... | −0.2 | −0.1 | −0.1 | −0.1 | −0.1 | −0.6 |
| 4. Restore and double deduction for adoption of special needs children | ..... | ..... | (1) | (1) | (1) | (1) | (1) |
| 5. Establish enterprise zone tax incentives | (2) | (2) | (2) | (2) | (2) | (2) | (2) |
| 6. Extend tax deadlines for Desert Shield participants (enacted in H.R. 4) | ..... | ..... | ..... | ..... | ..... | ..... | ..... |
| ***B. Expiring Tax Provisions*** | | | | | | | |
| 1. Permanent extension of R&E credit | ..... | −0.5 | −1.0 | −1.3 | −1.6 | −1.8 | −6.2 |
| 2. Extend R&E allocation rules (1 year) | ..... | −0.4 | −0.3 | ..... | ..... | ..... | −0.7 |
| 3. Extend low-income housing tax creedit (1 year) | ..... | −0.1 | −0.3 | −0.4 | −0.4 | −0.4 | −1.5 |
| 4. Extend targeted jobs tax credit (1 year) | ..... | −0.1 | −0.1 | −0.1 | (1) | (1) | −0.4 |
| 5. Extend business energy tax credits (1 year) | ..... | (1) | (1) | ..... | ..... | ..... | (1) |
| 6. Extend health insurance deduction for self-employed (1 year) | ..... | −0.3 | −0.1 | ..... | ..... | ..... | −0.4 |
| ***C. Compliance Provisions*** | | | | | | | |
| 1. Increase IRS enforcement funding [3] | ..... | ..... | ..... | ..... | ..... | ..... | ..... |
| 2. Improve retail compliance with alcohol special occupational taxes [4] | ..... | (5) | (5) | (5) | (5) | (5) | 0.1 |
| ***D. Other Tax Provisions*** | | | | | | | |
| 1. Extend Highway Trust Fund excise taxes (1 year) [4,6] | ..... | ..... | ..... | ..... | ..... | −2.8 | −2.8 |
| 2. Extend Medicare (HI) coverage to all State and local employees [3,4] | ..... | 1.1 | 1.5 | 1.5 | 1.5 | 1.5 | 7.2 |
| 3. Extend railroad unemployment insurance (UI) reimbursable status [3,4] | (1) | (5) | (5) | (5) | (1) | (1) | (5) |
| ***E. Certain User Fees*** | | | | | | | |
| 1. Extend abandoned mine reclamation fees [3] | ..... | ..... | ..... | ..... | ..... | 0.3 | 0.3 |
| 2. Increase HUD interstate land sales fee [3] | (7) | (7) | (7) | (7) | (7) | (7) | (8) |
| **Grand Total** [8] | **0.8** | **2.8** | **−4.2** | **−5.8** | **−6.1** | **−8.5** | **−20.8** |

[1] Loss of $50 million or less.

[2] Uncertainty about the size, location, and economic characteristics of enterprise zones to be designated makes the proposal difficult to estimate at this time.

[3] Estimate for this provision provided by the Congressional Budget Office (CBO).

[4] Net of income tax offsets.

[5] Gain of $50 million or less.

[6] Extend existing Trust Fund taxes from October 1, 1995, through September 30, 1996, but a 9 cents per gallon for gasoline and 15 cents per gallon for diesel fuel for the one-year extension period. Estimate is relative to the CBO baseline, which assumes extension of these motor fuels taxes at 11.5 cents per gallon for gasoline and 17.5 cents per gallon for diesel fuel (the Highway Trust Fund financing rates).

[7] Gain of less than $1 million.

[8] Not including the enterprise zones proposal (A. 5.).

Source: Joint Committee on Taxation; Congressional Budget Office (Items C.1., D.2., D.3., E.1., and E.2.)

**TABLE 13. COMPARISON OF LONG-TERM ECONOMIC PROJECTIONS**
**(percent change, calendar years)**

| | Actual | ---Forecast--- | | ----------Projections---------- | | | |
|---|---|---|---|---|---|---|---|
| | 1990* | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 |
| Gross National Product: | | | | | | | |
| Current dollars | 5.0 | | | | | | |
| Administration | | 4.1 | 7.1 | 7.2 | 7.0 | 6.6 | 6.4 |
| CBO | | 4.3 | 7.1 | 6.5 | 6.4 | 6.3 | 6.3 |
| DRI | | 2.9 | 6.7 | 5.8 | 5.8 | 6.0 | 5.8 |
| WEFA | | 4.1 | 6.0 | 6.4 | 7.3 | 8.0 | 7.8 |
| Constant (1982) dollars | 0.9 | | | | | | |
| Administration | | -0.3 | 3.1 | 3.5 | 3.3 | 3.1 | 3.0 |
| CBO | | 0.0 | 3.3 | 2.9 | 2.8 | 2.7 | 2.7 |
| DRI | | -0.4 | 3.5 | 2.9 | 2.9 | 2.4 | 2.0 |
| WEFA | | 0.7 | 2.9 | 2.7 | 3.0 | 3.1 | 2.7 |
| CPI Inflation | 5.2 | | | | | | |
| Administration | | 5.2 | 4.0 | 3.7 | 3.5 | 3.4 | 3.3 |
| CBO | | 4.9 | 3.5 | 3.6 | 3.6 | 3.6 | 3.6 |
| DRI | | 4.4 | 3.1 | 3.3 | 3.3 | 3.7 | 3.9 |
| WEFA | | 4.1 | 3.2 | 4.0 | 4.9 | 5.4 | 5.4 |
| Unemployment Rate (percent) | 5.5 | | | | | | |
| Administration | | 6.8 | 6.7 | 6.3 | 5.9 | 5.5 | 5.2 |
| CBO | | 6.8 | 6.4 | 6.2 | 6.0 | 5.8 | 5.6 |
| DRI | | 6.9 | 6.5 | 5.9 | 5.6 | 5.5 | 5.7 |
| WEFA | | 6.4 | 6.3 | 6.1 | 6.0 | 5.8 | 5.5 |
| Three-month Treasury Bill Rate (percent) | 7.5 | | | | | | |
| Administration | | 6.4 | 6.0 | 5.8 | 5.6 | 5.4 | 5.3 |
| CBO | | 6.6 | 7.0 | 6.7 | 6.3 | 5.9 | 5.7 |
| DRI | | 6.2 | 6.8 | 6.0 | 5.6 | 5.6 | 5.7 |
| WEFA | | 6.4 | 7.0 | 7.3 | 7.8 | 8.3 | 8.7 |
| Ten-Year Treasury Note Rate (percent) | 8.5 | | | | | | |
| Administration | | 7.5 | 7.2 | 6.8 | 6.6 | 6.4 | 6.3 |
| CBO | | 7.9 | 7.7 | 7.6 | 7.4 | 7.3 | 7.2 |
| DRI | | 8.2 | 8.5 | 7.9 | 8.2 | 7.9 | 7.9 |
| WEFA | | 7.9 | 8.2 | 8.5 | 8.9 | 9.3 | 9.8 |

*Actual as of February 1, 1991; administration forecasts based on estimates of 1990 made in December.

CBO Baseline Projections, January 1991
DRI Long-Term Forecast, January 1991
WEFA Group Long-Term Forecast, December 1990

**TABLE 14. EFFECTS ON CBO BUDGET PROJECTIONS OF SELECTED CHANGES IN ECONOMIC ASSUMPTIONS**
**(By fiscal year, in billions of dollars)**

| | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 |
|---|---|---|---|---|---|---|
| **Real Growth: Effect of One-Percentage-Point Lower Annual Rate Beginning January 1991** | | | | | | |
| Change in Revenues | -7 | -23 | -40 | -60 | -80 | -103 |
| Change in Outlays | 1 | 4 | 8 | 14 | 21 | 31 |
| Change in Deficit | 8 | 26 | 48 | 74 | 102 | 134 |
| **Unemployment: Effect of One-Percentage-Point Higher Annual Rate Beginning January 1991** | | | | | | |
| Change in Revenues | -28 | -42 | -43 | -44 | -46 | -47 |
| Change in Outlays | 5 | 8 | 12 | 16 | 21 | 25 |
| Change in Deficit | 33 | 49 | 55 | 61 | 66 | 73 |
| **Inflation: Effect of One-Percentage-Point Higher Annual Rate Beginning January 1991** | | | | | | |
| Change in Revenues | 6 | 17 | 30 | 45 | 61 | 78 |
| Change in Outlays | 5 | 18 | 30 | 43 | 57 | 71 |
| Change in Deficit | -1 | a | -1 | -2 | -4 | -7 |
| **Interest Rates: Effect of One-Percentage-Point Higher Annual Rates Beginning January 1991** | | | | | | |
| Change in Revenues | 0 | 0 | 0 | 0 | 0 | 0 |
| Change in Outlays | 5 | 15 | 22 | 28 | 33 | 37 |
| Change in Deficit | 5 | 15 | 22 | 28 | 33 | 37 |

SOURCE: Congressional Budget Office.

a. Less than $500 million.

TABLE 15.—ALTERNATIVE MEASURES OF FAMILY INCOME, BY INCOME QUINTILE AND CHANGE OVER TIME, 1973, 1979, 1989, FOR ALL FAMILIES (IN 1989 DOLLARS)

| Quintile | 1973 | 1979 | 1989 | Percent Change | |
|---|---|---|---|---|---|
| | | | | 1973–1989 | 1979–1989 |
| **I. Pre-Tax Cash Income** | | | | | |
| Mean cash family income (family weighted): | | | | | |
| Lowest | 6,061 | 5,994 | 5,866 | -3.2 | -2.1 |
| Second | 15,416 | 15,306 | 15,107 | -2.0 | -1.3 |
| Middle | 25,909 | 25,609 | 25,823 | -0.3 | 0.8 |
| Fourth | 37,946 | 38,680 | 40,374 | 6.4 | 4.4 |
| Highest | 66,364 | 68,230 | 77,716 | 17.1 | 13.9 |
| Average | 30,341 | 30,764 | 32,978 | 8.7 | 7.2 |
| Adjusted family income (person weighted):a/ | | | | | |
| Lowest | 5,216 | 5,218 | 4,993 | -4.3 | -4.3 |
| Second | 11,232 | 11,938 | 12,097 | 7.7 | 1.3 |
| Middle | 16,368 | 17,789 | 18,983 | 16.0 | 6.7 |
| Fourth | 22,863 | 25,016 | 27,643 | 20.9 | 10.5 |
| Highest | 39,805 | 42,826 | 51,230 | 28.7 | 19.6 |
| Average | 19,096 | 20,557 | 22,990 | 20.4 | 11.8 |
| Mean family income per capita (person weighted): | | | | | |
| Lowest | 2,795 | 2,912 | 2,822 | 1.0 | -3.1 |
| Second | 5,906 | 6,535 | 6,872 | 16.4 | 5.2 |
| Middle | 8,628 | 9,713 | 10,723 | 24.3 | 10.4 |
| Fourth | 12,386 | 14,046 | 16,058 | 29.6 | 14.3 |
| Highest | 23,875 | 26,405 | 32,237 | 35.0 | 22.1 |
| Average | 10,718 | 11,922 | 13,743 | 28.2 | 15.3 |
| **II. Post-Tax Income Plus Food and Housing Benefits** | | | | | |
| Adjusted family income (person weighted):a/ | | | | | |
| Lowest | N/A | 5,536 | 5,420 | N/A | -2.1 |
| Second | N/A | 10,962 | 11,019 | N/A | 0.5 |
| Middle | N/A | 15,495 | 16,484 | N/A | 6.4 |
| Fourth | N/A | 21,014 | 23,240 | N/A | 10.6 |
| Highest | N/A | 33,883 | 40,811 | N/A | 20.4 |
| Average | N/A | 17,374 | 19,395 | N/A | 11.6 |

a/Adjusted family income is income divided by the ratio of the n-person poverty threshold to the 1-person poverty threshold.
b/Per capita income is family income divided by family size.

Source: CBO based upon Census data

TABLE 16.--AVERAGE FAMILY CASH INCOME AS A FRACTION OF POVERTY ADJUSTED FAMILY INCOME BY FAMILY TYPE, QUINTILES BASED ON ADJUSTED FAMILY CASH INCOME, WEIGHTED BY PERSONS, 1973, 1979, AND 1989

| | | | | Percent Change | |
|---|---|---|---|---|---|
| | 1973 | 1979 | 1989 | 1973–89 | 1979–89 |
| All Families: | | | | | |
| Lowest | 0.90 | 0.90 | 0.86 | -4.3 | -4.3 |
| Second | 1.94 | 2.06 | 2.09 | 7.7 | 1.3 |
| Middle | 2.82 | 3.07 | 3.27 | 16.0 | 6.7 |
| Fourth | 3.94 | 4.32 | 4.77 | 20.9 | 10.5 |
| Highest | 6.87 | 7.39 | 8.84 | 28.7 | 19.6 |
| Average | 3.29 | 3.55 | 3.97 | 20.4 | 11.8 |
| All families with children: | | | | | |
| Lowest | 0.88 | 0.84 | 0.74 | -16.1 | -11.9 |
| Second | 1.88 | 1.95 | 1.87 | -0.7 | -4.2 |
| Middle | 2.65 | 2.84 | 2.93 | 10.8 | 3.3 |
| Fourth | 3.54 | 3.85 | 4.14 | 16.9 | 7.6 |
| Highest | 5.73 | 6.15 | 7.20 | 25.6 | 17.1 |
| Average | 2.94 | 3.13 | 3.38 | 14.9 | 8.0 |
| Married couples with children: | | | | | |
| Lowest | 1.16 | 1.18 | 1.14 | -1.1 | -2.9 |
| Second | 2.12 | 2.29 | 2.34 | 10.1 | 2.2 |
| Middle | 2.84 | 3.12 | 3.34 | 17.8 | 7.1 |
| Fourth | 3.71 | 4.11 | 4.52 | 21.9 | 10.2 |
| Highest | 5.94 | 6.41 | 7.67 | 29.2 | 19.8 |
| Average | 3.15 | 3.42 | 3.80 | 20.6 | 11.2 |
| Single mothers with children: | | | | | |
| Lowest | 0.33 | 0.32 | 0.25 | -23.4 | -22.9 |
| Second | 0.71 | 0.75 | 0.64 | -9.2 | -13.8 |
| Middle | 1.03 | 1.22 | 1.14 | 10.7 | -6.1 |
| Fourth | 1.67 | 2.01 | 2.03 | 21.5 | 0.6 |
| Highest | 3.29 | 3.65 | 4.14 | 26.0 | 13.5 |
| Average | 1.41 | 1.59 | 1.64 | 16.9 | 3.2 |
| Nonelderly childless units: | | | | | |
| Lowest | 1.22 | 1.24 | 1.19 | -1.8 | -3.9 |
| Second | 2.81 | 2.91 | 2.94 | 4.5 | 0.9 |
| Middle | 4.09 | 4.27 | 4.45 | 8.9 | 4.2 |
| Fourth | 5.49 | 5.78 | 6.29 | 14.5 | 8.8 |
| Highest | 8.95 | 9.35 | 10.94 | 22.3 | 17.1 |
| Average | 4.51 | 4.71 | 5.16 | 14.4 | 9.6 |

TABLE 16.--AVERAGE FAMILY CASH INCOME AS A FRACTION OF POVERTY ADJUSTED FAMILY INCOME BY FAMILY TYPE, QUINTILES BASED ON ADJUSTED FAMILY CASH INCOME, WEIGHTED BY PERSONS, 1973, 1979, AND 1989 (contd)

| | | | | Percent Change | |
|---|---|---|---|---|---|
| | 1973 | 1979 | 1989 | 1973-89 | 1979-89 |
| Nonelderly childless families: | | | | | |
| Lowest | 1.74 | 1.85 | 1.80 | 3.5 | -2.8 |
| Second | 3.31 | 3.59 | 3.68 | 11.1 | 2.5 |
| Middle | 4.53 | 4.89 | 5.20 | 15.0 | 6.3 |
| Fourth | 5.88 | 6.33 | 7.03 | 19.5 | 11.1 |
| Highest | 9.33 | 9.94 | 11.72 | 25.7 | 17.9 |
| Average | 4.96 | 5.32 | 5.89 | 18.8 | 10.7 |
| Nonelderly unrelated individuals: | | | | | |
| Lowest | 0.51 | 0.61 | 0.61 | 19.4 | -0.4 |
| Second | 1.49 | 1.72 | 1.83 | 23.1 | 6.4 |
| Middle | 2.53 | 2.78 | 3.00 | 18.8 | 8.0 |
| Fourth | 3.82 | 4.03 | 4.46 | 16.9 | 10.6 |
| Highest | 7.00 | 7.11 | 8.48 | 21.2 | 19.3 |
| Average | 3.07 | 3.25 | 3.68 | 19.9 | 13.1 |
| Elderly childless units: | | | | | |
| Lowest | 0.76 | 0.84 | 0.95 | 24.7 | 13.4 |
| Second | 1.34 | 1.50 | 1.73 | 28.6 | 14.8 |
| Middle | 1.97 | 2.26 | 2.64 | 34.1 | 16.9 |
| Fourth | 3.02 | 3.38 | 4.02 | 33.2 | 19.1 |
| Highest | 6.54 | 6.85 | 8.63 | 32.0 | 26.0 |
| Average | 2.73 | 2.97 | 3.59 | 31.8 | 21.2 |
| Elderly childless families: | | | | | |
| Lowest | 0.96 | 1.06 | 1.20 | 25.3 | 13.5 |
| Second | 1.63 | 1.86 | 2.15 | 31.5 | 15.2 |
| Middle | 2.34 | 2.67 | 3.14 | 34.0 | 17.4 |
| Fourth | 3.50 | 3.83 | 4.61 | 31.8 | 20.3 |
| Highest | 7.12 | 7.37 | 9.54 | 34.0 | 29.4 |
| Average | 3.11 | 3.36 | 4.13 | 32.7 | 22.9 |
| Elderly unrelated individuals: | | | | | |
| Lowest | 0.54 | 0.64 | 0.73 | 35.7 | 13.6 |
| Second | 0.93 | 1.02 | 1.17 | 26.1 | 14.7 |
| Middle | 1.23 | 1.37 | 1.62 | 32.2 | 18.2 |
| Fourth | 1.73 | 2.05 | 2.46 | 42.1 | 20.2 |
| Highest | 4.08 | 4.83 | 5.58 | 36.8 | 15.5 |
| Average | 1.70 | 1.98 | 2.31 | 36.0 | 16.7 |
| Other families with children | | | | | |
| Lowest | 0.88 | 0.81 | 0.73 | -17.1 | -10.4 |
| Second | 1.76 | 1.79 | 1.61 | -8.7 | -10.3 |
| Middle | 2.52 | 2.63 | 2.56 | 1.4 | -2.8 |
| Fourth | 3.43 | 3.59 | 3.69 | 7.6 | 2.9 |
| Highest | 5.32 | 5.88 | 6.46 | 21.4 | 9.8 |
| Average | 2.78 | 2.94 | 3.01 | 8.2 | 2.3 |

Source: CBO based upon Census data

TABLE 17.—SHARES OF FAMILY INCOME, BY INCOME QUINTILE AND CHANGE OVER TIME, 1973, 1979, 1989, FOR ALL FAMILIES (IN PERCENT)

| Quintile | 1973 | 1979 | 1989 |
|---|---|---|---|
| I. Pre-Tax Cash Income | | | |
| Mean cash family income (family weighted): | | | |
| Lowest | 4.0 | 3.9 | 3.6 |
| Second | 10.2 | 10.0 | 9.2 |
| Middle | 17.1 | 16.6 | 15.7 |
| Fourth | 25.0 | 25.1 | 24.5 |
| Highest | 43.7 | 44.4 | 47.1 |
| Adjusted family income (person weighted):a/ | | | |
| Lowest | 5.5 | 5.1 | 4.3 |
| Second | 11.8 | 11.6 | 10.5 |
| Middle | 17.1 | 17.3 | 16.5 |
| Fourth | 23.9 | 24.3 | 24.0 |
| Highest | 41.7 | 41.7 | 44.6 |
| Mean family income per capita (person weighted): | | | |
| Lowest | 5.2 | 4.9 | 4.1 |
| Second | 11.0 | 11.0 | 10.0 |
| Middle | 16.1 | 16.3 | 15.6 |
| Fourth | 23.1 | 23.6 | 23.4 |
| Highest | 44.6 | 44.3 | 46.9 |
| II. Post-Tax Income Plus Food and Housing Benefits | | | |
| Adjusted family income (person weighted):a/ | | | |
| Lowest | N/A | 6.4 | 5.6 |
| Second | N/A | 12.6 | 11.4 |
| Middle | N/A | 17.8 | 17.0 |
| Fourth | N/A | 24.2 | 24.0 |
| Highest | N/A | 39.0 | 42.1 |

a/Adjusted family income is income divided by the ratio of the n-person poverty threshold to the 1-person poverty threshold.
b/Per capita income is family income divided by family size.

Source: CBO based upon Census data

TABLE 18.--COMPOSITION OF AVERAGE DISPOSABLE INCOME AT VARIOUS WAGE LEVELS FOR A MOTHER WITH TWO CHILDREN WITHOUT CHILD CARE EXPENSES: 1972, 1980, AND 1990

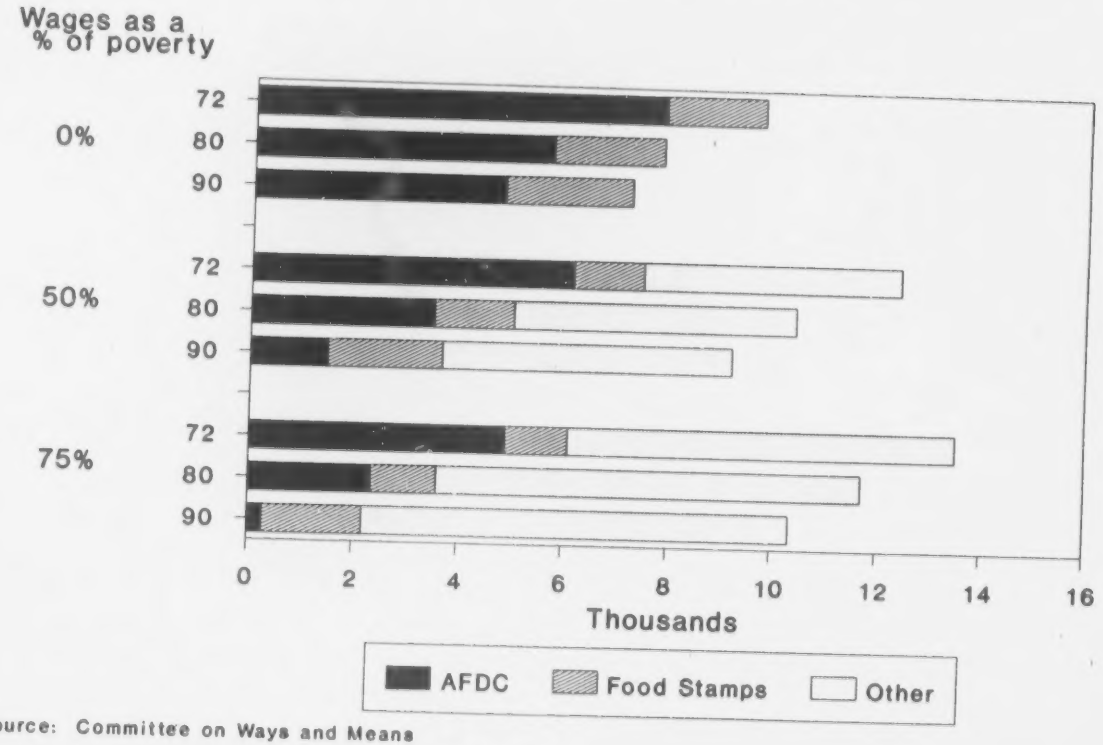
| | 1990 Dollars | | | | Percent Composition | | |
|---|---|---|---|---|---|---|---|
| Wages | 1972 | 1980 | 1990 | % Change 1972–90 | 1972 | 1980 | 1990 |
| **$0 (0% FPL)** | | | | | | | |
| AFDC | 7,836 | 5,699 | 4,801 | -39 | 80 | 73 | 66 |
| Food Stamps | 1,908 | 2,115 | 2,426 | 27 | 20 | 27 | 34 |
| Disposable Income | 9,744 | 7,814 | 7,227 | -26 | 100 | 100 | 100 |
| **$5,210 (50% FPL)** | | | | | | | |
| Wages | 5,210 | 5,210 | 5,210 | 0 | 42 | 50 | 57 |
| AFDC | 6,140 | 3,490 | 1,475 | -76 | 50 | 34 | 16 |
| Food Stamps | 1,335 | 1,530 | 2,187 | 64 | 11 | 15 | 24 |
| EITC | 0 | 521 | 729 | NA | 0 | 5 | 8 |
| Federal Taxes | (271) | (319) | (399) | 47 | -2 | -3 | -4 |
| Disposable Income | 12,414 | 10,432 | 9,202 | -26 | 100 | 100 | 100 |
| **$7,814 (75% FPL)** | | | | | | | |
| Wages | 7,814 | 7,814 | 7,814 | 0 | 58 | 67 | 76 |
| AFDC | 4,895 | 2,335 | 284 | -94 | 36 | 20 | 3 |
| Food Stamps | 1,189 | 1,253 | 1,895 | 59 | 9 | 11 | 18 |
| EITC | 0 | 781 | 953 | NA | 0 | 7 | 9 |
| Federal Taxes | (406) | (479) | (598) | 47 | -3 | -4 | -6 |
| Disposable Income | 13,492 | 11,704 | 10,348 | -23 | 100 | 100 | 100 |
| **$10,419 (100% FPL)** | | | | | | | |
| Wages | 10,419 | 10,419 | 10,419 | 0 | 72 | 83 | 87 |
| AFDC | 3,563 | 1,449 | 0 | -100 | 25 | 12 | 0 |
| Food Stamps | 1,043 | 883 | 1,341 | 29 | 7 | 7 | 11 |
| EITC | 0 | 681 | 953 | NA | 0 | 5 | 8 |
| Federal Taxes | (543) | (919) | (797) | 47 | -4 | -7 | -7 |
| Disposable Income | 14,482 | 12,513 | 11,916 | -18 | 100 | 100 | 100 |
| **$13024 (125% FPL)** | | | | | | | |
| Wages | 13,024 | 13,024 | 13,024 | 0 | 84 | 99 | 99 |
| AFDC | 2,499 | 794 | 0 | -100 | 16 | 6 | 0 |
| Food Stamps | 897 | 485 | 716 | -20 | 6 | 4 | 5 |
| EITC | 0 | 356 | 724 | NA | 0 | 3 | 6 |
| Federal Taxes | (949) | (1,470) | (1,315) | 39 | -6 | -11 | -10 |
| Disposable Income | 15,471 | 13,189 | 13,149 | -15 | 100 | 100 | 100 |

Note: Disposable income is wages plus AFDC plus food stamps less federal income and payroll taxes. Income is a weighted average across states. Dollars are adjusted for inflation using CPI-U. FPL is federal poverty level.

Source: Ways and Means Committee staff and based upon CRS state AFDC benefit levels.

**Chart 1.**

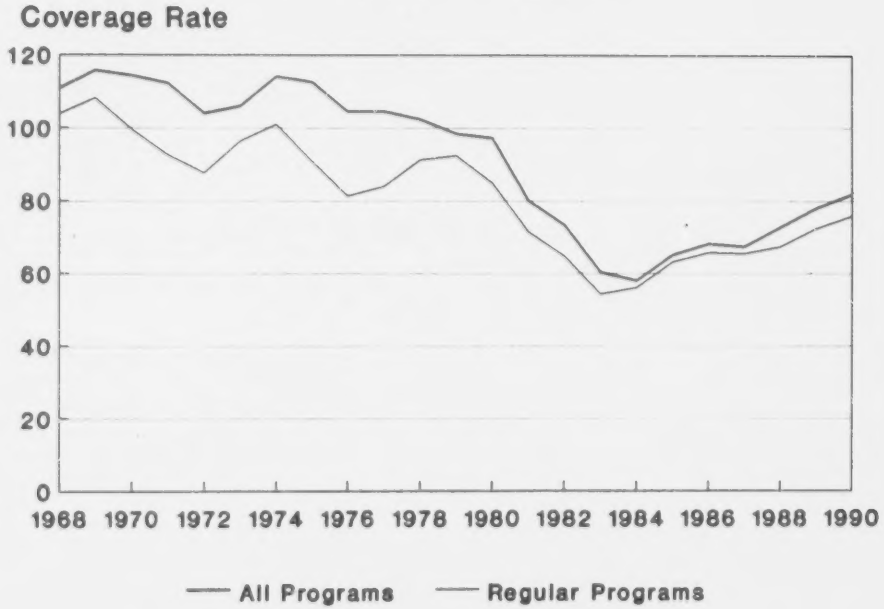
## Composition of Income at Various Wage Levels for a Mother and Two Children for Selected Years (1990 dollars)




Source: Committee on Ways and Means

**Chart 2.**

## Ratio of Insured Unemployment to Job Losers (Yearly Averages) 1968 - 1990




Note: Insured unemployment data include the Virgin Islands and Puerto Rico.

Source: Chart prepared by CRS based on data from the *Economic Report of the President, 1991.*

Table 19.—Selected Statistics on Families and Children

| Family Income (by population) | Percent Change in Real Income (1973–88) All families | Families with children | Non-Elderly with no children | Elderly |
|---|---|---|---|---|
| Poorest 20% | -8.6 | -20.8 | -5.6 | 22.1 |
| Next 20% | 5.6 | -2.6 | 2.9 | 27.2 |
| Middle 20% | 14.0 | 8.4 | 8.4 | 31.2 |
| Fourth 20% | 20.0 | 15.8 | 13.5 | 29.0 |
| Richest 20% | 25.4 | 23.5 | 19.8 | 22.3 |
| Average | 17.9 | 12.9 | 12.6 | 25.5 |

Source: Congressional Budget Office

| Percent of Children in Poverty | All Children | All < 6 | White | Black | Hispanic |
|---|---|---|---|---|---|
| 1966 | 17.6 | 18.1 | NA | NA | NA |
| 1979 | 16.4 | 18.3 | 11.8 | 41.2 | 28.0 |
| 1989 | 19.6 | 22.5 | 14.8 | 43.7 | 36.2 |

Source: Census

| Living Arrangements of Children | 1960 | 1970 (in thousands) | 1980 | 1989 | % Change 1980–89 |
|---|---|---|---|---|---|
| Total under 18 | 63,727 | 69,162 | 63,427 | 63,637 | 0.3 |
| Living arrangement: | | | | | |
| 1 parent | 5,829 | 8,199 | 12,466 | 15,493 | 24.3 |
| % of total | 9.1 | 11.9 | 19.7 | 24.3 | 23.4 |
| Never-Married Parent | 243 | 557 | 1,820 | 4,791 | 163.2 |
| % of total | 0.4 | 0.8 | 2.9 | 7.5 | 158.6 |

Source: Census

| Infant Mortality | All | White | Black | Other |
|---|---|---|---|---|
| Infant Death Rate | 26.0 | 20.0 | 12.6 | 10.1 |
| % Low Birthweight | 6.9 | 5.6 | 13.0 | 11.5 |

Includes blacks.
Source: National Center for Health Statistics

| Number of Children in Foster Care | 1975 | 1985 (in thousands) | 1988 |
|---|---|---|---|
| AFDC/Foster Care | 107 | 109 | 133 |
| Total Foster Care | NA | 276 | 323 |

Source: Health and Human Services

# PART 2—DESCRIPTION OF PROPOSALS AFFECTING PROGRAMS WITHIN THE JURISDICTION OF THE COMMITTEE ON WAYS AND MEANS

## MEDICARE

### 1. PPS Update

*Current law and background:*

The overall increase in PPS payment rates each year is determined by an update factor, and applies to payments for discharges occurring on or after Oct. 1 of each year. The updates for payments for many other covered Medicare services, specifically services covered under Part B, generally occur on January 1 of each year.

Since 1987, payments for the services of physician assistants in hospitals have been paid separately under Part B. Prior to this change, the cost of the services of physician assistants was included in the DRG payments to hospitals. OBRA 1986 required HCFA to reduce payments otherwise made to hospitals and skilled nursing facilities to offset payments to physician assistants under Part B. Authority for the offset was repealed in OBRA 1990.

*Description of proposal*

The budget proposes to move the hospital update to January 1, saving $670 million in fiscal year 1992.

The budget also proposes to save an additional $10 million in fiscal year 1992 by reducing the annual update to reflect the cost of physician assistant services that had been included in the DRG payment prior to 1987.

### 2. Indirect Medical Education

*Current law and background*

Medicare currently pays PPS teaching hospitals for the indirect costs associated with approved intern and resident programs. These indirect costs may be due to a variety of factors, such as extra demands placed on hospital staff due to the teaching activity, additional tests and procedures ordered by residents, or more severely ill patients treated at teaching hospitals. The payment adjustment is currently based on a formula that increases the Federal portion of the DRG payment by 7.7 percent. The payment amount increases for each 0.1 percent of the hospital's intern and resident to bed ratio on a curvilinear basis (an increase in the resident to bed ratio does not result in a proportional increase in payment).

*Description of proposal*

The budget proposal would reduce the factor used to calculate the payment adjustment for hospital indirect medical education costs from 7.7 to 3.2 percent over a five-year period, saving $1,045 in fiscal year 1992. The proposal would also redefine the ratio used to calculate the adjustment from the ratio of a hospital's number of interns and residents to the hospital's number of beds to a value based on the ratio of interns and residents to the hospital's average daily occupancy.

**3. Direct Medical Education**

*Current law and background*

Under current law, teaching hospitals also receive additional payment for the direct costs of medical education programs, such as the salaries and other education costs of interns, residents, nurses, and allied health professionals. These costs are not included in the PPS payment rates. Instead, payments for the direct costs of graduate medical education are based on Medicare's share of each hospital's direct costs per resident in a base year updated each year by the consumer price index. Payments are drawn from both Part A and Part B of Medicare.

*Description of proposal*

The budget proposal would limit Medicare payments for the direct costs of graduate medical education (i.e., internship and residency training programs for physicians) through the establishment of a per resident payment amount based upon the average salaries paid to residents nationally. Payments in support of primary care residents would be weighted at 240 percent of the average salary amount, non-primary care residents in their initial residency period would be weighted at 140 percent, and non-primary care residents beyond their initial residency period would be weighted at 100 percent. The proposal would save a total of $140 million in fiscal year 1992, $119 million from Part A and $21 million from in Part B, according to the President's budget.

**4. DRG Payment Window**

*Current law and background*

Outpatient services provided by a hospital within a certain period preceding an admission are considered to be a part of the admission. Payment for these services are included within the payment for the admission under the DRG payment system. This period is known as the DRG payment window. OBRA 1990 extended this window from 24 to 72 hours preceding the admission. There is currently no limit on payments for outpatient hospital services provided after discharge.

*Description of proposal*

The budget proposes to extend the DRG payment window to include services provided with 15 days of discharge. This would save an estimated $30 million in fiscal year 1992.

**5. Eliminate Return on Equity (ROE) Payments to Skilled Nursing Facilities (SNFs)**

*Current law and background*

Medicare currently pays a return on equity (ROE) for proprietary skilled nursing facilities. Equity includes all capital, net of depreciation, used for patient care, including loans from investors. SNFs are the only class of providers for which Medicare pays ROE.

*Description of proposal*

The budget proposes to eliminate ROE payments to skilled nursing facilities, saving $50 million in fiscal year 1992.

**6. Update for Physician Fees**

*Current law and background*

Current law provides that prevailing charges are updated annually by an economic index known as the Medicare Economic Index, or MEI. Since 1984, Congress has generally established the update percentage by legislation.

*Description of proposal*

The budget includes a regulatory proposal to make technical changes in the calculation of the MEI, saving an estimated $30 million in fiscal year 1992.

**7. Medicare Volume Performance Standard for 1991**

*Current law and background*

OBRA 1989 established a system of Medicare volume performance standards (MVPSs) for determining the update to physician services after 1992. OBRA 1990 established the MVPS for fiscal year 1991, computed as the baseline rate of growth, minus the change in the baseline due to the amendments included in OBRA 1990, minus 2 percentage points. The update in 1993 will be based, in part, on how the growth in actual expenditures compares to the 1991 MVPS targets.

*Description of proposal*

The budget includes a proposal to amend the specification of the MVPS for 1991 by multiplying the three factors together, as opposed to the additive method specified in OBRA 1990. The effect of this proposal would be to reduce the 1991 MVPS and, therefore, could potentially reduce the update in 1993. This proposal would not provide any savings in fiscal year 1992.

**8. Anesthesiology Services**

*Current law and background*

Payment for anesthesia services is based on a fee schedule. Physicians are also paid for supervising the services of certified registered nurse anesthetists (CRNAs) who provide anesthesia services. The combined payments to a CRNA and the supervising physician can exceed the amount that would be paid if the physician had personally performed the service.

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*Description of proposal*

The budget proposes to reduce the amount paid to physicians who supervise anesthesia services provided by CRNAs, such that the combined payments would be the same as when the physician personally provided the service. The amount paid for supervision would be the difference between the amount paid to the CRNA and the amount that would be payable to a physician for the same service. This proposal would save an estimated $80 million in fiscal year 1992.

**9. Payments for assistants-at-surgery**

*Current law and background*

Medicare currently pays for the services of physicians and physician assistants who act as an assistant at surgery. In general, the primary surgeon decides when the use of an assistant is appropriate. The payment for the assistant is in addition to any amount paid to the primary surgeon.

*Description of proposal*

The budget proposes to reduce the payment made to the primary surgeon on a case-by-case basis for any payments made to an assistant-at-surgery. Exceptions to this policy would be made for procedures where the use of an assistant is required due to the nature of the surgery. This proposal is projected to save $50 million in fiscal year 1992.

**10. Eliminate Payments for Specimen Collections**

*Current law and background*

Physicians may bill for the collection and handling of blood and urine specimens when the test is performed by an independent laboratory.

*Description of proposal*

The budget proposes to eliminate separate payments for these services when provided during an office visit. This would save $10 million in fiscal year 1992.

**11. Payments for Covered Drugs**

*Current law and background*

Medicare covers the cost of drugs that are provided on an outpatient basis when the drug cannot be self-administered. In general, this coverage is limited to drugs that must be injected. Payment for these drugs is based on a reasonable charge methodology.

*Description of proposal*

The budget proposes to limits payments for covered drugs to the wholesale price of the drug less 15 percent. This would save and estimated $10 million in fiscal year 1992.

**12. Payments for Radiology and Other Diagnostic Tests**

*Current law and background*

Radiology services and other diagnostic tests are paid on the basis of two components, a professional and a technical component. OBRA 1990 included a provision that limited the reasonable charge for diagnostic tests, other than radiology and clinical laboratory tests, to the national median of such payment amounts.

*Description of proposal*

Under this proposal, the Department would collect data that would determine the cost of providing the technical components of radiology and other diagnostic tests when performed by a reasonably efficient provider of services. Medicare payments for these services would then be adjusted accordingly. The proposal does not assume any savings in fiscal year 1992.

**13. Clinical Laboratory Services**

*Current law and background*

Clinical laboratory services are currently paid on the basis of area-wide fee schedules, subject to a nationwide cap equal to a percentage of the median value of the area-wide schedules. OBRA 1990 reduced the nationwide cap to 88 percent of the national median.

Claims for laboratory services are reimbursed at 100 percent of the fee schedule amount, and are not subject to the 20-percent coinsurance amount that applies to most other Part B services.

Laboratory fees generally are updated annually by the CPI. OBRA 1990 reduced the updates in 1991 through 1993 to 2 percent.

*Description of proposals*

The budget proposes to make payments for clinical laboratory services subject to the 20-percent coinsurance amount. This would reduce Medicare's payments for these services by an estimated $450 million in fiscal year 1992.

In addition, the budget proposes that the 2-percent update in 1992 and 1993 would apply only to services with a fee schedule amount that is below the national cap. This would save an estimated $20 million in fiscal year 1992.

**14. Durable Medical Equipment**

*Current law and background*

OBRA 1987 established local area fee schedules for Durable Medical Equipment (DME), effective Jan. 1, 1989. OBRA 1990 created national upper and lower limits on the local fee schedules. The upper limit for each item is equal to 100 percent of the national average payment. The lower limit is equal to 85 percent of the national average amount. These limits are being phased-in over a three year period.

Payments for oxygen services also are based on a fee schedule. According to a study conducted by the Office of the Inspector Gen-

eral, Medicare payments for oxygen are higher than the payments of other insurers.

Orthotic and prosthetic devices are not subject to the system of national limits. Payments for these devices and services are being phased into regional fee schedules.

Enteral nutritional products and supplies are used by patients who, as a result of chronic illness or traumatic injury, cannot ingest food orally. Under current law, payment for enteral supplies is the lowest of the actual charge, the customary charge, the prevailing charge, a "lowest charge level" screen, and an inflation adjusted charge.

*Description of proposals*

The budget includes four proposals in this area. These proposals would save a total of $45 million in fiscal year 1992.

The first proposal would define the upper and lower limits as based on the national median fee, instead of the national average.

The second proposal would reduce current payments for oxygen services and supplies by 5 percent.

The third proposal would make payments for orthotic and prosthetics devices and services subject to the same upper and lower national limits as apply to items of durable medical equipment.

The fourth proposal would establish a fee schedule for enteral and parenteral equipment and supplies. Payment for these items would be subject to the same upper and lower limits as durable medical equipment items.

**15. Hospital Outpatient Department Services**

*Current law and background*

Generally, payment for hospital outpatient department (OPD) services is on a cost-related basis. Special limits apply for ambulatory surgery services, and for radiology and other diagnostic tests. Overall, hospital outpatient department services represent one of the fastest growing components of the Part B program.

The coinsurance amount for services provided in OPDs is 20 percent of the OPDs' charges, as opposed to 20 percent of Medicare's cost-related payment amount.

OBRA 1990 established a schedule for consideration of reforms in the methodology for paying for services provided in hospital OPDs. The Secretary is to report to Congress on a prospective payment methodology for OPD services in September 1991.

*Description of proposal*

The budget proposes to phase-out cost-related payments for most OPD services. Payments for most outpatient surgery would be limited to the lesser of the rate currently paid to free-standing ambulatory surgical centers and the average OPD costs for the same procedure. Payments for radiology, other diagnostic tests, and minor surgical procedures not currently reimbursed in ambulatory surgical centers would be based on the technical component of the fees established under the physician RB RVS. In each case, the payment would be the same whether the services is provided in an OPD, free-standing facility, or physician office.

The coinsurance obligation would be changed to 20 percent of Medicare's payment.

The update to the rates paid to free-standing ambulatory surgical facilities would be changed from July 1 to January 1 to conform with the updates for most other Part B services.

**16. Payments to Providers for Physical and Respiratory Therapy Services**

*Current law and background*

Medicare pays for the services of physical and respiratory therapists provided in hospital outpatient departments (OPDs), skilled nursing facilities (SNFs), home health agencies (HHAs) and comprehensive outpatient rehabilitation facilities (CORFs). When these services are provided under arrangement, as opposed to when they are provided by employees of such facilities, Medicare's payment is based on an amount that is equivalent to the salary that would be paid to an employee who provides the service. This "salary equivalence" was initially determined in 1983. Since then, it has been updated for inflation by 0.6 percent per month. This update reflects the level of inflation in salaries that was projected in 1983. Actual inflation in salaries since 1983 has been somewhat lower.

*Description of proposal*

The salary allowances for the cost of physical and respiratory therapy provided under arrangements would be adjusted to reflect actual inflation in salaries, saving an estimated $10 million in fiscal year 1992.

**17. Home Health Cost Limits**

*Current law and background*

Home health agency services are reimbursed on a cost-related basis. Cost limits are used to determine the reasonable costs. OBRA 1986 required that a uniform, aggregate limits be applied across all types of disciplines providing services through a home health agency.

*Description of proposal*

The aggregate cost limits would be replaced with a system of separate limits for each discipline providing services. This would save an estimated $90 million in fiscal year 1992.

**18. Uniform Medicare Secondary Payor Employee Size Threshold**

*Current law and background*

Medicare is a secondary payer under specified circumstances when Medicare beneficiaries are covered by other third party payers, including employer group health plans, automobile, no-fault and liability insurance. Under the working aged provisions, Medicare is secondary to employer group health plans with 20 or more employees.

In the case of disabled Medicare beneficiaries, Medicare is secondary payer for individuals covered by a "large group health

plan" defined as an employer or employee organization plan of an employer that employees at least 100 employees.

*Description of proposal*

The size of firm threshold under the Medicare secondary payer provisions for the disabled and for end stage renal disease (ESRD) beneficiaries would be amended so that Medicare is secondary to employer group heath plans that cover employers with 20 or more employees. The definition of individuals subject to the disabled secondary payer provisions would be revised to include only those beneficiaries covered under a group health plan by reason of current employment or the employment of a family member. This would save an estimated $80 million in fiscal year 1992.

**19. Part B Premium**

*Current law and background*

From 1984 through 1990, the monthly Part B premium has been set at 25 percent of program costs for the elderly and adjusted for interest income to provide for an appropriate contingency margin. The remaining 75 percent is covered by general revenues.

For years 1991 through 1995, the Part B premium is set at a level to reflect CBO estimates of the level necessary for the part B premium to cover 25 percent of program costs though 1995: $29.90 in 1991, $31.80 in 1992, $36.60 in 1993, $41.10 in 1994 and $46.10 in 1995.

*Description of proposal*

The budget proposes to income-test Part B premiums for Medicare beneficiaries. The proposal would reduce the Part B subsidy for individuals with annual adjusted gross incomes (AGI) above $125,000 and couples with AGIs above $150,000. These individuals would be required to pay a Part B premium equal to 75 percent of total Part B program costs. For individuals with incomes above this threshold, the monthly Part B premium would be $95.40 in 1992, increasing to $138.30 in 1995. The proposal would save an estimated $42 million in fiscal year 1992.

**20. State and Local Government Employee HI Coverage**

*Current law and background*

Prior to the enactment of the Consolidated Omnibus Reconciliation Act of 1985 (COBRA), State and local employees were covered under the Medicare system only if the State and the Secretary of Health and Human Services entered into a voluntary agreement providing for coverage under the Social Security and Medicare programs. In COBRA, the Congress extended Medicare coverage (and the corresponding hospital insurance payroll tax) on a mandatory basis to State and local government employees hired after March 31, 1986, for services performed after that date.

State and local workers hired prior to April 1, 1986 by a governmental entity with continuous employment with that entity since that date are not required to be covered under Medicare. State and local governments are not required to pay the Hospital Insurance

(HI) payroll tax of 1.45 percent on behalf of these workers, nor do the employees.

*Description of proposal*

State and local employees hired before April 1, 1986 would be required to be covered under Medicare. This proposal would produce additional revenues of $1,234 million in fiscal year 1992, according to the President's budget.

**21. Survey and Certification User Fees**

*Current law and background*

The Health Care Financing Administration (HCFA) administers the survey and certification program that surveys various health facilities that provide services under Medicare and Medicaid, and laboratories that must be certified under the Clinical Laboratory Improvement Act of 1988 (CLIA). Under CLIA, laboratories are charged a fee for the certification process. The costs of the Medicare and Medicaid survey and certification processes are currently financed out of the appropriations for program management within HCFA.

*Description of proposal*

The Administration's budget includes a proposal to fund the Medicare and Medicaid facility survey and certification programs through user fees levied on the facilities being surveyed, including hospitals, nursing homes, and facilities providing services to end-stage renal disease (ESRD) beneficiaries. The budget estimates that the revenues from these fees would provide net savings of $250 million in fiscal year 1992.

**22. Coordinated Care Initiatives**

*Current law and background*

Medicare currently allows beneficiaries to enroll in health maintenance organizations (HMO). For beneficiaries electing to enroll in an HMO, these organizations provide coordinated care across the entire range of Medicare covered benefits. For beneficiaries not electing the HMO option, all Medicare covered services are provided through the traditional health care delivery systems.

*Description of proposal*

The Administration's budget includes a proposal to fund the development of coordinated care initiatives. This would include the coordination of the delivery of medical services provided by a variety of different entities. These initiatives would emphasize primary and preventive care and, according to the Administration's budget, would have the potential of providing improved health care at a lower cost. These initiatives would cost $40 million in fiscal year 1992.

## SOCIAL SECURITY AND RAILROAD RETIREMENT

### 1. Social Security Retirement Test

*Current law and background*

Social Security beneficiaries with earnings above specific thresholds may have some or all of their benefits withheld to take into account these earnings. In 1991, beneficiaries under age 65 have their benefits reduced by $1 for every $2 of earnings over $7,080. Beneficiaries age 65–69 have their benefits reduced by $1 for every $3 of earnings over $10,800. This threshold is projected by the Congressional Budget Office to rise to $10,200 in 1992, $10,680 in 1993, and $11,400 in 1994 under automatic provisions. The retirement test does not apply to beneficiaries age 70 and older.

*Description of proposal*

The annual earnings threshold under the retirement test for individuals age 65–69 would be increased by $800 in 1992 and $200 in 1993. The increases would not be cumulative, and the threshold would continue at its current-law level in 1994 and thereafter. Under the proposal, the thresholds would be $11,000 in 1992, $10,880 in 1993, and $11,400 in 1994.

### 2. Social Security Administration (SSA) Staffing (nonlegislative proposal)

During the 1980's, SSA staff was reduced by 20 percent. Staffing levels were essentially stabilized with the FY 1991 budget, and the FY 1992 budget calls for a modest increase of 1,258 Full Time Equivalents (FTEs) in SSA staffing, bringing total employment at the agency to 64,530. About two-thirds of this increase, or 800 FTEs, would be funded by a temporary supplemental appropriation which the Administration is requesting to implement the *Zebley* Supreme Court decision. The *Zebley* decision requires SSA to re-evaluate the disabilities of a large number of children whom it previously denied Supplemental Security Income benefits.

Disability case backlogs are rising. Currently, SSA takes three months to process a disability claim. Even if the President's FY 1992 request is approved in full, this waiting period is expected to increase to six months next year. In addition, about 60,000 disability applications have not been assigned to a disability examiner for action due to already heavy workloads and increasing numbers of applications.

### 3. Social Security Benefits for Railroad Retirement Dependents

*Current law and background*

Railroad retirement Tier 1 benefits are in most cases identical to Social Security benefits and are computed under the Social Securi-

ty benefit formula. However, benefits for certain dependent family members that would be payable if the worker had worked under social security are not paid at all under railroad retirement. These dependents include the child of a retired or disabled worker, the retired divorced spouse of a railroad worker who has not yet retired, the spouse or divorced spouse of a disabled worker under age 62, and a surviving spouse who elects to withdraw pre-1974 taxes paid under railroad retirement in a lump sum rather than receiving monthly benefits. In addition, railroad retirement does not pay a lump sum death benefit if the recipient of the benefit is entitled to a railroad retirement benefit for the month of the worker's death.

*Description of proposal*

Social Security benefits would be paid to those family members of railroad workers who do not receive benefits that they would be eligible for had the worker been employed under Social Security. It appears that the claims would be processed by the Social Security Administration.

## CHILD SUPPORT ENFORCEMENT

### 1. Incentive Payments

*Current law and background*

Under the Child Support Enforcement program the Federal government makes incentive payments to States in proportion to a measure of their cost-effectiveness, which is the ratio of child support collections to administrative costs. Under the formula, each State receives an incentive payment equal to at least 6 percent of the State's total amount of AFDC child support collections for the year. The same formula applies to non-AFDC case collections. The amount of the State's incentive payment could reach as high as 10 percent of collections, depending on the State's cost-effectiveness ratio.

*Description of proposal*

The maximum Federal incentive payments to States for child support enforcement collections would be reduced from 10 to 5 percent. New incentives rewarding other aspects of child support enforcement, such as establishing paternities or support obligations, would be added up to 10 percent of collections on behalf of AFDC families. In addition, the proposal would require States to reinvest these incentive payments in programs benefiting children.

### 2. Application Fees

*Current law and background*

State child support enforcement programs may charge application fees for child support enforcement and paternity establishment services to non-AFDC families of up to $25.

*Description of proposal*

States would be required to charge an application fee of $25 for non-AFDC cases and an annual user fee of $25 thereafter. The user fee would be charged only in cases which receive support collections from the State. States would be permitted to increase these fees to $50 each and could choose to charge only individuals with incomes above 185 percent of the poverty line.

## SUPPLEMENTAL SECURITY INCOME

### 1. Fee for Administration of State Supplementation

*Current law and background*

The Social Security Administration administers the State supplementation of SSI benefits in 17 States and the District of Columbia. No fee is charged for this service.

*Description of proposal*

The Social Security Administration would be authorized to charge States fees for the Federal cost of administering State supplemental SSI payments.

### 2. Collection of SSI Overpayments

*Current law and background*

The Social Security Administration (SSA) can collect overpayments to SSI recipients if such collection does not violate "equity and good conscience." Furthermore, SSA cannot collect the overpayment by reducing the SSI benefit without a written agreement with the recipient, and the amount of the collection cannot exceed the lesser of the benefit amount or 10 percent of the recipient's total income. However, once a recipient goes off SSI and onto Title II Social Security benefits, no offset collection is available.

*Description of proposal*

The Social Security Administration would be authorized to collect SSI overpayments by reducing Title II Social Security benefits paid to those no longer eligible for SSI.

## UNEMPLOYMENT COMPENSATION

*Current law and background*

The Federal government grants funds to the States for administration of the unemployment insurance system. When unemployment increases, the President usually asks for a supplemental appropriation to cover the costs of additional unemployment insurance claims.

*Description of proposal*

A $100 million supplemental appropriation would be passed to cover increased State administrative expenditures resulting from higher unemployment insurance claims. However, more recent unofficial estimates suggest the supplemental appropriation should be about $200 million. The Administration has asserted that there is enough room within the domestic spending cap established by the Budget Enforcement Act of 1990 to allow for this appropriation without triggering a sequestration. If this turns out not to be true, the Department of Labor has proposed to rescind Summer Youth program funds to make room for this appropriation.

## CHILD WELFARE SERVICES AND FOSTER CARE

### 1. Title IV-B Funding

*Current Law and background*

The title IV-B child welfare services program authorizes $325 million per fiscal year to the States for child welfare services. For fiscal year 1991, $273 million was appropriated for the program.

*Description of proposal*

Funding for the title IV-B child welfare services program would equal $364 million for fiscal year 1992, an increase of $90 million over the prior fiscal year. The increased funds are linked to a proposal which reforms financing of foster care administrative costs (see following proposal). $10 million would be used for demonstration projects to test the effectiveness of intensive, home-based family intervention services as a means of preventing foster care placement.

### 2. Prohibition on reimbursement for pre-placement activities

*Current law and background*

States receive Federal reimbursement under the title IV-E foster care maintenance payments program for child placement services and administrative costs at a rate of 50 percent. Current law requires States to undertake certain pre-placement activities which are reimbursed in this category. For example, States must make reasonable efforts to prevent or eliminate the need for the removal of a child from the child's home. In addition, the State is required to develop a case plan and prepare for and participate in a judicial proceeding.

*Description of proposal*

Would prohibit Federal reimbursement for certain, unspecified expenditures related to "pre-placement" activities under the title IV-E foster care maintenance payments program.

## AFDC AND THE TITLE XX SOCIAL SERVICES BLOCK GRANT

*Current law and background*

Generally, administrative costs under the Aid to Families with Dependent Children program are reimbursed to the States on an open-ended entitlement basis at a rate of 50 percent, except that an enhanced match of 90 percent is available for the costs associated with designing, developing, and operating automated data systems.

The title XX social services block grant is a capped entitlement program that provides funds to the States for a broad range of social services. No State match is required under this block grant.

*Description of proposal*

Would consolidate a number of programs and turn the programs over to the States in the form of a block grant, with the goal of providing Federal funds in a more flexible form. Would include in the list of possible program candidates the following programs: (1) State administrative expenses for Medicaid, AFDC and Food Stamps; and (2) the title XX social services block grant.

## TRADE ADJUSTMENT ASSISTANCE

### 1. Terminate the TAA Program

*Current law and background*

The Trade Adjustment Assistance (TAA) program for workers and firms has been amended and reauthorized several times under the Trade Act of 1974 since it was first established in 1962, and currently extends until September 30, 1993.

This special assistance program provides weekly cash allowances, training benefits, and job search and relocation allowances to workers and technical assistance to firms and industries that are certified by the Departments of Labor or Commerce as adversely impacted directly by increased imports. The weekly cash payments to workers are an extension of unemployment compensation (UC) weekly benefit amounts, payable upon exhaustion of UC for up to 78 weeks of UC and TAA payments combined, conditional generally on worker participation in an approved training program. Benefits to firms consist of technical assistance to prepare a petition for certification or the required adjustment plan and/or to implement an approved plan. The benefits for workers are an entitlement program.

*Description of proposal*

Legislation will be proposed by the administration to terminate the separate TAA program for workers as of October 1, 1991, and to serve workers displaced by imports through the Economic Dislocation and Worker Adjustment Assistance program under Title III of the Job Training Partnership Act beginning in fiscal year 1992. Workers collecting TAA benefits during the week including September 30, 1991, would continue to collect the balance of their TAA entitlements. The administration also proposes termination of the discretionary TAA program for firms in 1992.

## OTHER PROPOSALS

### 1. Internal Revenue Service and the Budget

The President proposes funding for the Internal Revenue Service of $6.73 billion in fiscal year 1992, which is a 10.6-percent increase over the fiscal year 1991 level. The proposed funding increases are directed toward: personnel costs ($255.5 million); information systems ($245 million); workload costs ($75.6 million); and, compliance initiatives involving collections ($34 million), examination field audits ($6 million), appeals in chief counsel ($4 million), employee plans ($1.3 million) and criminal investigations ($.7 million).

The President indicates that IRS's accounts receivable inventory is a high risk area requiring intensive efforts in 1991. Further, the President reports an initiative underway to study the feasibility of offsetting tax refunds to businesses with delinquent Federal debt.

### 2. Bureau of Alcohol, Tobacco, and Firearms and the Budget

The President proposes funding for the Bureau of Alcohol, Tobacco, and Firearms of $317 million, which is a 3.7-percent increase over the fiscal year 1991 level. The President proposes a decrease of $9 million for the Bureau's compliance operations, which ensure collection of alcohol, tobacco and firearms excise taxes, and an increase of $20 million for the Bureau's law enforcement programs. The President proposes to decrease compliance operations' alcohol inspections by 63 percent, tobacco inspections by 53 percent, and firearms inspections by 7 percent in fiscal year 1992. The President shows a savings of $1 million by requiring wholesalers to verify the alcohol Special Occupational Tax status of retailers.

### 3. Pension Benefit Guarantee Corporation and the Budget

The President reports that overall funding of defined benefit pensions is good. However, a minority of plans are still underfunded. The Administration estimates that these underfunded plans have $20 billion to $30 billion in unfunded pension liabilities. The President reports that PBGC's deficit over the next 30 years is likely to climb to $6 billion and, under pessimistic economic assumptions, could reach $20 billion. However, premium increases included in OBRA 1990 should provide a positive cash flow through the end of the century.

The President will propose legislation to clarify and improve the status of PBGC bankruptcy claims, to revise the legal treatment of contingent early retirement benefits (such as shut-down benefits), to allow PBGC to become a member of creditors' committees in bankruptcy, and to tighten interest rates used to determine certain contributions to underfunded plans.

## 4. Federal Debt Management and the Budget

### a. Resolution Trust Corporation (RTC)

The President reports that, at the end of November 1990, RTC had resolved 332 institutions of the over 516 thrifts it had taken over. The President projects that the RTC may take over an additional 500 institutions and RTC needs additional loss funding of $30 billion in fiscal year 1991 and $33 billion in fiscal year 1992. In addition, the President shows the Federal Financing Bank lending $47 billion in fiscal year 1991 and $43 billion in fiscal year 1992 to RTC for working capital. Under present law, RTC shall manage and resolve all cases involving depository institutions which are in conservatorship or receivership as of three years from the enactment of FIRREA (August 1989). The President proposes extending this period from August 1992 to the end of fiscal year 1993.

### b. Government-Sponsored Enterprises (GSEs)

The President estimates outstanding GSE obligations totaling $981 billion in fiscal year 1991 and $1 trillion in fiscal year 1992. The President finds that, in general, the direct risk to taxpayers from GSEs is not large. The President reports that there are weaknesses in the Farm Credit System and proposes reforms to reduce the Federal exposure.

The President also reports that the larger effects on financial markets of GSE activities need to be examined. Further, the President notes that it is difficult to foresee the effects on taxpayers from managerial and operational risks as well as the risks associated with changes in the overall business environment for GSEs. Finally, OMB has begun studying the possibility of measuring yearly changes in the Government's exposure to losses from firms operating with implicit Federal guarantees.

# PART 3—READINGS

REMARKS BY HON. LOUIS W. SULLIVAN, M.D., SECRETARY OF HEALTH AND HUMAN SERVICES, AT THE TETELMAN LECTURE/YALE UNIVERSITY, NOVEMBER 28, 1990, NEW HAVEN, CONN.

Thanks very much, Dr. Lytton, and thank you all for that warm welcome. It's a great honor to have been invited by Jonathan Edwards College and Yale University to join you as a Tetelman Fellow, following in the footsteps of so many distinguished scientists and physicians upon whom you have previously bestowed this singular honor.

My lecture this morning will range far beyond what we normally consider science and medicine. Indeed, we will venture into some territory that this college's namesake, Jonathan Edwards, would have found familiar. For I propose to talk about the role of individual responsibility in health care today, and our need to cultivate a new "culture of character" within this nation.

But first, a word of context. My discussion today is part of a larger dialogue that I am conducting with the American people, about the problems afflicting our nation's health care system, and some possible solutions. Recent events in Washington have reminded us once again that, before we attempt to make significant change and reform in our health care system, we must first explore thoroughly with the American people the problems we face, and the difficult and painful choices we must make.

Upon the firm foundation of mutual understanding and trust, we can build the widespread and durable consensus that must undergird any proposed changes in our system of health care.

Last month, at Stanford, I discussed the factors that have driven the dramatic rate of increase in health care costs. In future presentations, I will talk about providing essential health care to those who are currently underserved; the structure of public and private insurance; and the effectiveness of our medical practices.

But today, I wish to discuss the critical role that a renewed sense of personal responsibility must play, as we seek to forge a more effective, less costly, and more humane system of health care. For the harsh truth is that a high percentage of the disease and disability afflicting the American people is a consequence of unwise choices of behavior and lifestyle.

Those poor choices result in lives that are blighted, stunted, and less fulfilling, and they cause an unnecessary, costly drain on the resources available for health care.

The decision to smoke, for instance, is responsible for one of every six deaths in America each year. The cumulative toll is 390,000 deaths per year, including 21% of heart disease deaths, 87% of lung cancer deaths, and 30% of all cancer deaths. In addition, smoking is responsible for 20 to 30% of low birth weight babies. Smoking costs our society over $52 billion annually.

Abuse of alcohol was responsible for one half of the 30,000 motor vehicle deaths in 1988, and 40% of the drownings. Drinking is a major cause of cirrhosis, the ninth leading cause of death in the United States; it has been linked to violence, homicide and suicide; and its costs to society amounted to some $70 billion in 1989.

Improper diet and inadequate exercise are other major contributors to poor health outcomes. Poor diet is related to five of the ten leading causes of death in the U.S., including coronary heart disease, some types of cancer, stroke, and diabetes. Together, unhealthy diet and sedentary habits contribute to 300,000 to 400,000 deaths each year.

For children and youth, injuries are the leading cause of death. The lifetime costs of injuries were estimated to be $158 billion in 1985.

Problems of behavior and lifestyle contribute to some of the leading health problems facing this nation, including infant mortality, heart disease, and cancer.

If we are to bring better lives to all Americans -- and if we are to cope with the dramatic increases in health care costs in America -- it will be necessary for us to address directly the problem of ill-advised choice of behavior and lifestyle. And taking on this challenge, carries us well into the difficult realms of ethics and culture.

Now, this is not a comfortable passage for physicians and health care professionals -- nor for Americans in general. By our actions, it would appear that we would rather avoid the issue of appropriate, healthy behavior altogether. But, clearly, our avoidance is ill-advised, both from the standpoints of healthy, fulfilling lives, and of financial costs.

Why do we approach health this way? In part, I believe, because we have seen such miraculous achievements in medical science that we believe that medical science can, indeed, fix virtually any ailment. Our faith in medicine grows ever stronger as we push out the frontiers of research, unveiling more of the secrets of life. Consequently, we have come to think of medicine as a safety net, strong and wide enough to catch all who fall from the high wire of an unhealthy lifestyle.

Even as our trust as a society in medical science grows, however, I am troubled by diminishing confidence in our willingness and ability as a society and individuals to make sound judgments about healthy human behavior and lifestyles. Linked to this declining faith in ethical and value judgment is an erosion of those institutions that have generated, shaped, and sustained our ethical and cultural standards -- family, neighborhood, church, school, and voluntary associations. As a consequence of this institutional decline, we have fewer sources of instruction in healthy, constructive behavior.

I leave it to the students and faculty of this splendid university to explore fully the profound issues of science, ethics, and philosophy into which we've ventured as a society. But from my practical standpoint -- as a physician, and as Secretary of Health and Human Services -- let me simply say this: every day, all about me, I see the toll of our ethical dilemma, the tragic price of our cultural indifference -- not only in the prevalence of preventable disease and injury, but also in the vast range of social problems afflicting the American people -- drug and alcohol addiction, escalating child abuse and neglect, children born to unwed teen mothers, families abandoned or never formed. So many of these problems have their roots in the alienation, isolation, and lack of direction that follow from the collapse of societal standards, and the institutions that generate them.

That is why I have travelled from one end of the country to the other over the past two years, calling for a renewed sense of personal responsibility on the part of every American citizen -- in short, a new "culture of character."

By "character," I mean the personal values and qualities encompassed by that sturdy, time-honored word -- values like self-discipline, integrity, taking responsibility for one's acts, respect for others, perseverance, moderation, and a commitment to serve others and the broader community.

By "culture," I mean these values that must be embraced as cornerstones of our society. I seek to remind Americans that we can best cultivate character in our citizens by reinvigorating and shoring up those institutions that teach and nurture values and principles of healthy behavior, especially the institutions of family and community.

I certainly came to appreciate, in my own experience, the critical value of strong families and communities, and the standards they nurture. The neighborhoods in Atlanta and Blakely, Georgia, where I grew up, were by no means wealthy, but they <u>were</u> genuine communities -- joined together in joy and sorrow, sharing our benefits and burdens, committed to common values and principles.

I was not just the child of my father and mother -- I was in fact a child of the entire neighborhood. When I was out of sight of the folks and thought I could get away with something, Mr. Jones or Mrs. Smith down the block was sure to step in and administer appropriate, corrective caring -- whether I liked it, or not.

Now, I have to admit, there were times when all this caring about my personal life was not particularly welcome. But I have since come to appreciate just how critical that attention and discipline are. Through it I learned certain values -- reinforced at every turn by my family, neighbors, church, and school -- values that carried me to medical school, and that carried you into your studies and professions -- values like self-esteem, self-discipline, the desire to learn, responsibility, and service.

In short, my neighborhood built around me a culture of character -- an ethic of personal responsibility. As my beloved mentor, the late Dr. Benjamin Elijah Mays, former president of Morehouse College, put it, I learned that "It is not your environment, it is you -- the quality of your mind, the integrity of your soul, the determination of your will -- that will decide your future and shape your life."

Translated into strategies that would mean healthier, longer lives for all citizens, a new culture of character calls upon Americans to end drug abuse; avoid the high risk behavior that spreads the AIDS virus; reduce consumption of alcohol; seek early prenatal care; improve eating habits; wear seat belts and take other necessary precautions; increase exercise; learn to resolve conflicts without resort to violence; seek the necessary medical examinations and vaccinations; and, yes, stop smoking.

Were we to follow these injunctions, studies have shown that we could eliminate 45% of deaths from cardiovascular disease, 23% of deaths from cancer, and more than 50% of the disabling complications of diabetes. Indeed, control of fewer than ten risk factors, including the above -- could prevent between 40 and 70% of all premature deaths, a third of all cases of acute disability, and two-thirds of all cases of chronic disability.

Just as important, a new culture of character in America, nurtured by strengthened families and communities, would do much to alleviate the alienation, isolation and despair that fuel teen pregnancy, violence, drug and alcohol abuse and other social problems afflicting us. The lives of Americans would be healthier in every sense of the word.

Now, I have heard it said that my call to a new culture of character is in fact nothing more than a way of diverting attention from a Federal government and a society that refuses to provide the resources necessary for better health care for all Americans.

To be sure, poverty is linked to ill health and social dysfunction -- so let us never be guilty of suggesting to our citizens that first they must be wealthier, before they can be healthier. But, many impoverished families and neighborhoods have sustained the values and institutions necessary for healthy, productive lives -- lives that will eventually lead them out of poverty.

To suggest that our poor and minority citizens cannot improve their lives, by drawing on their own strong, traditional values and institutions, is not only inaccurate, it is patronizing and insulting. To counsel them to sit and wait patiently for massive new Federal (or other) programs is to counsel resignation, defeat, pessimism, and despair.

Ill-advised choices of behavior and lifestyle characterize all strata of American society. And so the call for a new culture of character applies with equal force to all Americans, regardless of income, race, sex, or other status.

Let me be clear about another aspect of the "culture of character." It by no means puts the onus for healthy behavior exclusively on the individual, nor does it rely simply on a heightened sense of personal responsibility. That's why our culture -- the broader realm of social, economic, and political institutions that shape our lives -- figures centrally in my message. We must mobilize all those institutions in the cause of healthier, more productive lives for our citizens.

The Federal government is playing a leadership role by marshalling all facets of society behind disease prevention and health promotion, as demonstrated most recently by our report of health goals for the nation, entitled Healthy People 2000 -- a careful, thorough enunciation of certain clearly defined health goals to be reached by the turn of the century. We are also working to elevate the status of preventive services in our approach to health care delivery and health policy reform.

More broadly, the Federal government today is working to revitalize institutions like the family and local community, which cultivate healthier, life-sustaining values. This approach carries us beyond the attitude of the 60s, 70s, and 80s, when government retreated from active social policy.

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We now know that Federal programs are most effective when they work through, and help to reinforce, active, indigenous community groups. And so today, we are providing resources and assistance to community coalitions that are striving to prevent the spread of AIDS; halt drug and alcohol abuse; provide early childhood development programs; counsel young minority males; reduce violence; bring expectant mothers into prenatal care programs; and a vast range of other activities.

Workplace America also has a role to play in building a new culture of character. Businesses must become far more attentive to the health and lifestyle of their employees, both by discouraging unhealthy behavior like smoking and drug and alcohol abuse, and by encouraging positive behavior, like exercise and proper diet.

Equally important, some corporations must be held accountable when they undertake actions that erode the culture of character. Heavily promoting alcohol and tobacco sales in low-income communities is one such reprehensible act.

The media and cultural leadership groups also have a vital role to play in shaping a new culture of character in America. If they can help us celebrate solid values and institutions, then Americans will be far more likely to adopt healthy lifestyles.

A step in the right direction is the dramatic turn-about in Hollywood's and Madison Avenue's treatment of drug use. Where once it was accepted, today it is the target of a highly effective, voluntary multi-million dollar prevention campaign. This is a good example of what can be accomplished, if our media leaders can be mobilized behind healthier lifestyles.

Finally, within my own profession of medicine, health promotion and disease prevention must play a much larger role. We must work to redress the imbalance in health care expenditures devoted to promoting health versus treating disease -- currently, only 4% of total expenditures go to prevention -- and we must make prevention a central part of the improved primary health care that we are striving to make available to all Americans. Above all, physicians must overcome their reluctance to venture into the personal, private behaviors of those to whom we minister, in order to give them thoughtful counsel about the effect their choices have on their health.

This brings me to one final comment about my vision for a new culture of character in America. It is a culture in which we not only are more careful about our own health behavior, but also more attentive to the behavior of those around us -- our family members, friends, neighbors, and coworkers.

We must have the courage to point out the dangers of unhealthy, self-destructive behaviors in those around us, as well as voice approval for their healthy behaviors. And when these judgments are rendered -- not out of smugness, or self-righteousness, or condemnation, but out of compassion, concern, and love -- when they come in the spirit of family and friendship -- then the message of a new culture of character will have discovered its most effective and profound voice.

My plea for a new culture of character, a new ethic of personal responsibility, is by no means intended to be a substitute for the changes that we must make in our broader system of health care. Government will have to be more active on behalf of those who are underserved by current health care arrangements -- especially our poor and minority citizens -- as I will discuss at another time.

But I believe that, as we struggle to overcome the barriers to healthier lives for all our citizens, we can learn much from the experience of the Black community in America. That experience teaches us that progress and reform are most likely to come when we pursue a two-fold strategy: first, strive to change the external circumstances that are unjust and hold us back; but second, strive to reinforce the strength of character necessary to survive and prosper in spite of adverse circumstances.

Neither strategy in isolation is sufficient; both strategies together cannot fail to bring significant progress and reform. Frederick Douglas, for example, worked not only to abolish the social circumstance of slavery; he also sought to build better individuals, by emphasizing the importance of character. "With character we can be powerful," he proclaimed. "Nothing can harm us so long as we have character."

In our time, the outstanding leaders of our community continue to pursue both strategies simultaneously. Dr. Martin Luther King, Jr. resolutely pursued changes in society's laws and institutions, so that one day his daughters would not be judged by the color of their skin. But at the same time, he worked to prepare people for the day when they would be judged by the "content of their character."

Similarly, Jesse Jackson's quest for social and economic change in the larger society is joined inseparably to a call for personal reform, for better character. As he put it, "When you drink liquor, and when you take drugs, and when you sell drugs, and when you shoot people and when you rob people . . . nobody can save you but you from yourself."

So today, as we search for ways to ensure that our expenditures for health care are wisely spent, and not squandered treating unnecessary and preventable disease -- more important, as we search for ways to bring healthier, safer, more fulfilling and productive lives to all our citizens -- let us pursue both strategies at once. Let us not only seek ways to change and improve our health care system -- let us search for ways to improve ourselves -- our behavior and lifestyles, our values, indeed, our very character.

A new culture of character is not the entire answer to the health care dilemmas we face. But it is an essential, crucial part of the answer. And it is a vital key to better lives for all Americans.

Thank you very much.

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# TESTIMONY BY HON. ALAN GREENSPAN, CHAIRMAN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, BEFORE THE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS OF THE UNITED STATES SENATE, FEBRUARY 20, 1991

Mr. Chairman and members of the Committee, I am pleased to appear before you again at these monetary policy oversight hearings. As is the convention on these occasions, I shall focus my remarks this morning on monetary policy and the current situation in the economy. However, the events of the past year have once again underlined the ways in which the state of our nation's banking system can affect the transmission of monetary policy to the economy. Consequently, I think I should comment at least briefly on some of the regulatory issues bearing on the willingness of banks to extend credit.

I should like to start, however, with an overview of the economic outlook. As you know, business activity turned down in the latter months of 1990, and appeared still to be declining through the early part of February. With the unpredictability of events in the Middle East compounding the usual uncertainties attending any economic projection, it would be most unwise to rule out the possibility that the recession may become more serious than already is apparent. Nonetheless, the balance of forces does appear to suggest that this downturn could well prove shorter and shallower than most prior post-war recessions. An important reason for this assessment is that one of the most negative economic impacts of the Gulf war--the run-up in oil prices--has been reversed. Another is that the substantial decline in interest rates over the past year and a half--especially in the past several months--should ameliorate the contractionary effects of the crisis in the Gulf and of tighter credit availability.

The major danger to a near-term recovery is that the erosion in purchasing power and frayed consumer and business confidence stemming from the recession and war could interact with a weakened financial system to produce a further decline in the economy. The recent actions we have taken, along with the ranges for growth of money and credit this year, which I shall be discussing in a moment, were designed to reduce the probability of such an outcome and to support a resumption of sustainable economic growth, in the context of progress toward price stability.

Economic and Monetary Policy Developments in 1990 and Early 1991

When I last testified on our monetary policy objectives in July, the economy appeared likely to continue growing, though moderately. The objective of restoring a clear downward tilt to the path of underlying inflation while maintaining the economic expansion thus seemed attainable. Indeed, data that became available subsequently indicated behavior of economic activity in the third quarter consistent with that appraisal.

That said, evidence in July of weaknesses in certain regions and sectors of the economy signalled caution. Notably, deteriorating market conditions for commercial real estate were limiting the ability of some borrowers to service loans, which, along with the restructuring of thrift institutions, induced lenders to pull back from extending credit to this sector. Banks also were becoming less willing to make business loans--not only for highly leveraged transactions, but more generally where industry or local economic conditions looked at all

unfavorable. Tendencies toward such restraint, which might normally have been expected in a time of uneven and generally less robust business prospects, were exacerbated by pressures on the capital positions of many institutions. In mid-July, to better ensure the economy's continued growth, the Federal Reserve adopted a slightly more accommodative stance in reserve markets to counter the potential effect on spending of this tightening of credit terms at depository institutions.

The invasion of Kuwait in early August dramatically altered the economic landscape. Oil prices surged, simultaneously worsening prospects for both real income and inflation. The higher world oil prices transferred domestic purchasing power to foreign oil exporters, while uncertainties about how the crisis would be resolved shook household and business confidence. After the invasion, spending held up for a time before starting to soften, while the jump in oil prices fed through quickly to energy prices more generally and to measures of overall inflation. Amid considerable volatility in financial markets and concern about the inflation outlook, bond rates moved back up and stock prices moved down, as many investors shifted to more liquid instruments. Treasury bill rates eased, and a surge in purchases of money market mutual fund shares boosted growth of the broader monetary aggregates in August and September.

Oil prices, which peaked at more than $40 per barrel in early October, seemed to be the primary source of financial market uncertainty and volatility; however, the fitful progress toward agreement on measures to reduce the federal deficit also contributed. When the budget

accord was finally reached in late October, its promise of fiscal restraint over the next several years was reflected in somewhat lower bond yields. Against a backdrop of weakening economic activity and in light of the passage of the multi-year deficit-reduction package, the Federal Reserve again eased money market conditions.

This policy action proved to be only the first of a series of easing moves extending through early this month. These moves were prompted in part by subsequent information pointing to sizable contractions of consumer outlays and economic activity stemming from the marked weakening of consumer confidence and purchasing power. They also were taken in response to a lessening of wage and price pressures and decidedly sluggish growth in the monetary aggregates after their surge in August and September. Following continued moderate expansion in the third quarter, real GNP turned downward, led by the decline in consumer spending, but also reflecting reduced construction activity and business inventory investment. Industrial production began a rapid descent in October, with the motor vehicle industry accounting for an especially large share of the drop. Private employment also started to fall steeply, and the unemployment rate rose further. The associated rise in layoffs brought increased uncertainty to the household sector, which in turn has kept consumer spending subdued.

The widening economic slack helped prevent the energy price surge from becoming embedded in ongoing wage and price inflation. The increases in nominal wages and broader compensation measures diminished in the fourth quarter, after exhibiting initial signs of slowing in the

preceding three months. In September, the non-energy component of the Consumer Price Index began to rise at a slower pace. And in the final two months of the year, inflation in the overall CPI fell back, as energy prices topped out in November and declined in December in the wake of lower crude oil prices. The success of Coalition military operations after the outbreak of war in mid-January was seen in oil markets as reducing the odds of wide-ranging supply disruptions, and oil prices retreated still more, further improving the near-term outlook for inflation.

This reduction of cost and price pressures has given the Federal Reserve scope to move aggressively to counter contractionary influences on the economy without contributing to market concerns about the inflation outlook. Absent such a lessening of price pressures, monetary policy easing probably would have risked a heightening of inflation expectations, which could have put the foreign exchange value of the dollar under severe downward pressure and fed through to long-term interest rates, perhaps even pushing them higher.

The easing of policy also was keyed to the meager expansion since September of the broader monetary aggregates. As I shall be discussing more fully, the slowdown in money growth was worrisome because it seemed to reflect a further tightening of credit availability as well as the weakening in spending. The surfacing of additional asset quality problems has heightened financial strains on many banking institutions, placing pressures on capital positions and boosting funding costs. In turn, banks have progressively tightened their standards

for granting loans and have set still more restrictive terms and conditions on the loans they have made. Strains also have been evident at other intermediaries, and many securities have been downgraded by the rating agencies, suggesting that even those borrowers not relying on banks in many cases have faced higher costs and more restrictive terms.

In responding to evidence of economic weakness, to a lessening of inflation pressures, and to slow monetary growth, the Federal Reserve has used all three of its key policy tools. More accommodative reserve provision through open market operations, together with two cuts in the discount rate totaling a full percentage point, have brought the federal funds rate down to around 6-1/4 percent. This important short-term rate has fallen 2 percentage points since mid-1990 and roughly 3-1/2 percentage points over the past two years. We also reduced the remaining reserve requirement on nonpersonal time and similar accounts from 3 percent to zero. The requirement to hold non-earning reserves at the Federal Reserve in effect imposes a tax on credit intermediation at banks and thrifts. This action lowered this tax and was aimed specifically at relieving the tightening of credit availability at depository institutions.

Other short-term market interest rates generally have fallen nearly as much as the federal funds rate since mid-1990. Long-term interest rates also have retreated, and rates on fixed-rate mortgages are now in the vicinity of their lows of the past decade. Lower interest rates and oil prices have helped to lift some major stock price indexes to all-time highs. After firming in December and early January

on safe-haven demands, the exchange value of the dollar has shown unwelcome weakening tendencies at times recently.

The Behavior of Money and Credit in 1990 and Early 1991

As I indicated earlier, sluggish expansion of the monetary aggregates was an important ingredient in the decisions to ease policy during recent months. The broader aggregates ended 1990 well down in the lower halves of their annual growth ranges. The Federal Open Market Committee recognized that the relationship between M2 and spending is uncertain, but the slower growth of M2 in the latter part of 1990 and early 1991 brought the aggregate so far below our expectations that it seemed highly likely to be inconsistent with the Committee's longer-run objectives for the economy.

The weakness in M2 is a complex development and requires careful interpretation. The shortfall from our expectations appeared to be related to the stalling of nominal income in the fourth quarter, and also to the circumstances surrounding the extraordinary decline in assets at depository institutions last year, which in turn had implications for future as well as current spending. As their willingness or capacity to expand their assets diminished, banks and thrifts became less eager to attract deposits of all kinds. Hence, they paid unusually low rates on retail deposits in M2 relative to market interest rates. Moreover, public attitudes toward deposits also seemed to have been adversely affected by developments in the depository sector; publicity about thrift closings, Bank Insurance Fund losses, and credit quality

problems at commercial banks evidently encouraged shifts of funds into Treasury securities or alternative nondeposit instruments.

The shifting of credit intermediation away from depositories appeared likely to be having a damping effect on the spending of those borrowers without ready access to alternative sources of funds at comparable interest rates. Thus, part of the slow growth in retail deposits could be seen as symptomatic of developments in the credit granting process with adverse implications for contemporaneous and future aggregate demand.

However, a portion of the credit flows no longer being intermediated by depositories has been readily replaced by alternative suppliers. In particular, markets for securities backed by mortgages and consumer loans have allowed demands for these types of credit to be met with little or no increase in costs to the ultimate borrowers. And some businesses with relatively high credit ratings have had little difficulty switching from banks to commercial paper markets and other sources of short-term funding. The reduction in funding through retail deposits associated with this type of shift in credit flows would not signal a weakness in current or future spending. Some of the surprising weakness in M2 growth has been reflected simply in a higher velocity than otherwise, rather than having been indicative of restraint on spending. M2 velocity last year did not exhibit the decline that would be expected with the drop in short-term market interest rates in late 1989 and 1990.

But with not all of the weakness in M2 likely to be offset by a lasting shift in velocity, the behavior of this aggregate seemed

increasingly to signal a weaker path for the economy than consistent with the Committee's intentions. Our policy easings over recent months were keyed partly to reinvigorating growth of M2 to a rate more likely to be consistent with satisfactory economic performance. If history is any guide, the policy-induced declines in interest rates on market instruments relative to returns on M2 balances will generate the desired speed-up in M2 growth; indeed, we have begun to see some evidence of that in recent weeks, though it is still too early to be very confident that a new, more robust growth trend has been established.

Restrained growth of M3 last year was expected once the size of the runoff of thrift assets and of RTC activities became clear. But its increase was further depressed by a larger-than-expected decline in bank credit growth. The fall-off in total depository assets had an especially pronounced effect on M3 because this aggregate includes, in addition to retail deposits, certain managed liabilities whose issuance is more sensitive to overall depository funding needs. In fact, currency and money market mutual funds more than accounted for the expansion in this aggregate over 1990. M3 growth has picked up this year, but so far it has reflected the substitution by some depositories of large time deposits for non-M3 funding sources rather than a renewed expansion of their credit.

Although credit outstanding at depositories contracted last year, credit flows at other intermediaries and in the open market were better maintained. Some borrowers undoubtedly felt the effects of

tightening lending terms, but nonetheless the debt of domestic, non-federal sectors rose 5-3/4 percent last year. This growth rate, though considerably lower than in recent years, was well in excess of the percentage increase in nominal income. Growth of federal debt by contrast surged to 11 percent, of which more than 2 percentage points represented federal funding of Resolution Trust Corporation activities. Buoyed by federal government borrowing, the total debt of domestic nonfinancial sectors grew 7 percent, the midpoint of the FOMC's monitoring range for the aggregate.

Economic Prospects in 1991 and Monetary Policy Plans and Objectives

These economic, financial, and monetary conditions form the starting point for the Federal Reserve's view of economic prospects and plans for monetary policy in 1991. An important aspect of the outlook is the unusually high degree of uncertainty about how these conditions will evolve, in the face of the Gulf war and financial strains. Another is the recognition that there may be substantial lags between changes in financial conditions--notably, the decline in interest rates and the depreciation of the dollar in recent months--and the response of spending. The assessment of the FOMC, as captured by the central tendency of the individual projections of Board members and Reserve Bank presidents, is that the odds favor a moderate upturn in activity in coming quarters. Real GNP for the year as a whole is anticipated to grow in the area of 3/4 to 1-1/2 percent. Unemployment is likely to rise further before the recovery takes hold, and consequently the expectation is that the jobless rate will be somewhere between 6-1/2 and 7 percent at year-end.

The lower oil prices, if they persist, will help damp overall inflation, as will slack in labor and capital resources. Most of us believe that consumer prices will rise 3-1/4 to 4 percent this year--the best performance in several years.

The forces currently at work in restraining spending can be readily identified. Consumer and business confidence still looks to be quite depressed, evidently because of the high degree of uncertainty, as well as the weak economy. Moreover, problems in many parts of the real estate sector are not going to be resolved soon. In particular, the large stock of vacant commercial properties is virtually certain to limit activity in that sector for some time. It also will take a while to correct the associated financial difficulties facing many lenders, who are likely to remain quite conservative in making new loans. Finally, secondary effects on aggregate demand of the recent decline in our economy's output and real income are now in process of running their course.

Fortunately, several stimulative forces are in motion that enhance the chances of economic recovery. Monetary policy easings have brought about a significant drop in short-term interest rates. The decline started more than a year before the business cycle peak, a pattern unique in post-war experience and one which should help cushion the current recession. Moreover, short-term rates have declined substantially further in recent months. Long-term interest rates also have come down appreciably; reduced mortgage rates already have improved the affordability of housing, and thus should help to revive housing sales

and starts. The enhanced international competitiveness of our industries augers well for the net export component of GNP. Furthermore, the fall in oil prices, which was especially marked in mid-January, has restored considerable domestic purchasing power. With most businesses having kept their inventories lean, the anticipated pickup in aggregate demand should show through relatively quickly in rising production.

The 1991 ranges for money and debt growth were selected by the Federal Open Market Committee to promote sustainable economic recovery, consistent with progress over time toward price stability. In keeping with a long-term disinflationary path, the FOMC ratified the provisional ranges set last July, which embody a 1/2 percentage point reduction in the M2 range compared with the limits for 1990. The midpoint of the 2-1/2 to 6-1/2 percent range for M2 growth matches the midpoint of the central tendency of the projections by the governors and presidents for nominal GNP growth. The recent sizable declines in short-term market rates normally would be expected to elevate the growth of M2 relative to that of nominal GNP. However, the FOMC anticipates that, as an offset, the ongoing restructuring of the thrift industry, combined with continued hesitancy of many banks to expand their assets, will again create an environment that restrains M2 growth relative to nominal GNP expansion and buoys M2 velocity. An outcome this year involving little change in M2 velocity would be quite similar to last year's experience.

The 1 to 5 percent range for M3 growth this year is the same as the sharply reduced range for last year. It again is lower than the

bounds for M2 growth because M3 is likely to continue to be more depressed than M2 by restructuring of the thrift industry and restrained growth in bank credit. The annual monitoring range for debt, however, has been reduced 1/2 percentage point relative to last year's specification, to 4-1/2 to 8-1/2 percent, in line with the sustained deceleration of this aggregate in recent years.

Risks to the Economic Outlook

These money and debt ranges are wide enough to afford scope for policy reactions should the economy or its relationship to these financial aggregates diverge from FOMC expectations. Indeed, the individual forecasts of Board members and Reserve Bank presidents for the economy cover a relatively wide range. This divergence of opinion has its roots in the major uncertainties facing all forecasters today. Economic forecasters typically have had great difficulty in projecting business-cycle turning points, that is, judging when the relative strength of contending economic forces of contraction versus expansion will reverse. Moreover, the current outlook is unusually clouded, in part by uncertainties about the war and its effects. The Federal Reserve will need to remain alert to possible contingencies and will have to continue to respond flexibly to information about evolving trends.

Monetary policy thus will depend on how trends in economic activity and inflation actually unfold. Downside risks in the economic outlook are obviously there and not difficult to identify. For example, an extended war with Iraq clearly could carry some risk of further

undercutting public confidence and spending. Additional restraint on credit availability at depositories or increased public concern about the health of the banking system would be negative factors as well, and could show up initially as continued subpar money growth.

The worry has been expressed that, under current conditions of restrained willingness of depository institutions to extend credit, monetary policy easing moves may have only a minimal impact on lending and hence on overall spending. I believe this risk is exaggerated. Our easings and reserve requirement action have lowered bank funding costs appreciably. Some of this decline has been passed through to borrowers in the form of a lower prime rate; even with this reduction, funding costs have fallen relative to loan rates, and with higher profit potential banks should be more inclined to extend credit. Moreover, monetary policy stimulus works through other channels as well. Some potential borrowers will be encouraged by lower market interest rates to undertake additional expenditures financed, either directly or indirectly, by issuance of securities. Spending effects also can appear through routes involving price responses in equity and foreign exchange markets. Finally, the anticipated economic recovery itself will help allay problems of credit availability at, and public trust in, depository institutions. Indeed, there is some possibility that once the economy turns around, the expansion could become fairly robust, sparked by a return of consumer and business confidence and fueled by increasing availability of credit.

Regulatory Initiatives

Monetary policy will continue to be conducted to foster attainment of important macroeconomic objectives. In so doing, we will need to remain mindful of any impediments to the process of credit intermediation. But monetary policy cannot resolve market imperfections in which credit for some financially sound projects is more expensive or less available than might otherwise seem warranted. Structural problems involving imperfections in credit and capital markets require structural solutions. To the extent that current banking regulations are impeding the efficient functioning of these markets, a more promising approach would lie along the path of revising those regulations. I would like to offer several thoughts along these lines, some of which are in only the formative stages.

We already have taken the step, as noted, of reducing reserve requirements on nontransaction accounts at banks and thrifts so as to eliminate the reserve tax on lending financed through these sources. This action lowered non-interest bearing required reserve balances at Federal Reserve Banks by some $11-1/2 billion. The Federal Reserve Board also has the authority to reduce the required reserve ratio on transaction deposits from its current 12 percent to as low as 8 percent. However, unusual volatility in the federal funds rate appeared in January and early February, as required reserve balances moved to a seasonal low point. This experience suggests that reserve balances had fallen so far that many depository institutions were encountering difficulties in managing their reserve balances to meet day-to-day clearing

needs. Subsequently, volatility in the federal funds rate has diminished, as required reserve balances have begun to move above their seasonal lows, and as institutions have enlarged their clearing balances. These developments should continue for a time. Even so, the experience early this year suggests caution in considering further reductions in required reserve ratios, at least for a while. We shall, however, continue to assess this situation.

The recent episode of more volatile funds trading also has underscored the increased reluctance depositories have exhibited in recent years in availing themselves of short-term adjustment credit at the discount window. The reluctance has stemmed from fears of being identified as having more fundamental funding problems. Because of depository reluctance, the discount window in recent years has been a less effective safety valve in relieving transitory pressures in the reserves and funds markets. Tapping the window for adjustment credit, when alternative sources of funds temporarily are not available on reasonable terms from usual sources, is not indicative of longer-term stresses at borrowing institutions. Despite bank reluctance, borrowing has been somewhat higher on occasion this year as banks were in the process of adapting to the lower reserve requirements. We would not be surprised to see somewhat higher adjustment borrowing persist. The Federal Reserve has no desire to circumscribe the legitimate use of the discount window, and market participants should not interpret such use as indicating underlying problems for the institutions involved.

Another regulatory area in which possible steps are being considered pertains to the guidelines used in the supervisory process. The Federal Reserve is working with the other bank supervisory and regulatory agencies to ensure that bank examination standards are prudent and fair and do not artificially encourage or discourage credit extension. The intent of these efforts is to contribute to a climate in which banks make loans to creditworthy borrowers and work constructively with borrowers experiencing financial difficulties, consistent with safe and sound banking practices. For example, the agencies are studying steps to clarify that the supervisory evaluation of real estate collateral is to be based, not solely upon liquidation prices, but upon the ability of a property to generate cash flow, given reasonable projections of rents, expenses, and rates of occupancy over time. We need a balanced evaluation process that endeavors to reflect the long-term value of an illiquid asset, rather than the exaggerated appraisals that have been evident in both the upside and the downside of the real estate cycle in recent years.

The supervisory agencies also are seeking to encourage banking institutions to provide additional public disclosure on their nonperforming assets. Under present circumstances, as best we can judge, the market tends to suspect the worst. Additional disclosure would supplement data on the level of nonperforming loans with information on the amount of such loans that are in fact generating substantial cash income. Other similar steps are under consideration.

In general, we have emphasized our view that prudent lending standards and effective and timely supervision should not inhibit banking organizations from playing an active role in financing the needs of sound, creditworthy borrowers. Such an approach can contribute to the efficient functioning of credit markets and thereby complement monetary policy in promoting the attainment of the nation's overall economic objectives.

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